By the same authors

ELEMENTARY ECONOMICS (3rd ed., 1948)
ELEMENTARY PRINCIPLES OF ECONOMICS (6th ed., 1951)
ELEMENTS OF INDIAN ECONOMICS (5th ed., 1951)

INDIAN ECONOMICS

A Comprehensive and Critical Survey

BY

G. B. JATHAR, M.A.

Indian Educational Service (Retired)
Principal, Karnatak Education Board's Arts and Science College
Dharwar

AND THE LATE

S. G. BERI, M.A.

Bombay Educational Service (Class I)
Professor of Economics, Sydenham College of
Commerce and Economics, Bombay

VOLUME II

NINTH EDITION

GEOFFREY CUMBERLEGE
OXFORD UNIVERSITY PRESS

Oxford University Press, Amen House, London E.C. 4
GLASGOW NEW YORK TORONTO MELBOURNE WELLINGTON
BOMBAY CALCUTTA MADRAS CAPE TOWN
Geoffrey Cumberlege, Publisher to the University

FIRST PUBLISHED 1929
SECOND EDITION 1931
THIRD EDITION 1932
FOURTH EDITION 1937
FIFTH EDITION 1939
SIXTH EDITION 1941
SEVENTH EDITION 1945
EIGHTH EDITION 1949
NINTH EDITION 1952

PRINTED IN INDIA AT THE DIOCESAN PRESS, MADRAS AND PUBLISHED BY GEOFFREY CUMBERLEGE, OXFORD UNIVERSITY PRESS, MADRAS—1952. C913

PREFACE

In this the ninth edition of this volume, while the general structure of the text remains practically unaltered, a number of changes in detail have been made. The figures quoted and the facts have been brought down to date by using such material as was available at the time the actual revision was made. While the process of printing a volume of this size is gradual and necessarily covers several months, water is flowing under the bridges all the time. It is therefore inevitable that by the time publication is achieved, portions of the text should cease to be quite up to date. However, in order to catch up with the latest developments, the following appendixes have been added as supplements to the main text:

A. Summary of the Report of the Fiscal Commission, 1949-50.
B. Main Provisions of the Indo-Pakistan Trade Agreement, 1951-2.
C. India's Foreign Liabilities and Assets.
D. Report of the Rural Banking Inquiry Committee, 1950.
E. Central Budget, 1951-2.
F. Railway Budget, 1951-2.

The appendixes run to twenty-five pages, but this addition has been more than compensated for by the severe pruning to which parts of the main text have been subjected.

Among subjects which are new or which have received a somewhat more extended treatment in this edition may be mentioned the devaluation of the rupee in September, 1949; the Banking Companies (Control) Ordinance, 1948, and Banking Companies Act, 1949; the distribution of the burden of taxation; and the Deshmukh Award of 1950.

G. B. J.

Dharwar,
1 July 1951

SYNOPSIS OF CONTENTS

CHAPTER VII

TRADE AGREEMENTS [*pp.* 203-24]

CHAPTER VIII

CURRENCY AND EXCHANGE (PART I) [*pp.* 225-63]

Chapter IX

CURRENCY AND EXCHANGE (Part II) [*pp.* 264-95]

Chapter X

PRICES IN INDIA [*pp.* 296-309]

Chapter XI

BANKING AND CREDIT [*pp.* 310-63]

CHAPTER XII

FINANCE AND TAXATION [*pp.* 364-430]

CHAPTER XIII

UNEMPLOYMENT [*pp.* 431-46]

APPENDIXES [*pp.* 447-71]

INDEX [*pp.* 472-80]

CHAPTER I

INDUSTRIALIZATION: MEANS AND METHODS

§1. The main argument for protection in India.—Advocates of protection as an important means for promoting industrialization in India rely mainly on what is called the infant industry argument. It is assumed that under protection a large number of industries will spring up and, if assured of reasonable profits during the early years of development, they will rapidly grow in strength and efficiency so that they will be able eventually to dispense with all artificial aid, and that the loss entailed during the initial stages of development will be more than covered by the ultimate advantage to the nation. The Fiscal Commission (1924) quote with approval the following words of Professor A. C. Pigou, pointing out their obvious applicability to India: 'The case for protection with a view to building up productive power is strong in any agricultural country which seems to possess natural advantages for manufacturing. In such a country the immediate loss arising from the check to the exchange of native produce for foreign manufactures may well be outweighed by the gain from the greater rapidity with which the home manufacturing power is developed. The ' crutches to teach the new manufactures to walk' , as Colbert called protective duties, may teach them this so much earlier than they would have learnt it, if left to themselves, that the cost of the crutches is more than repaid.'[1]

§2. Protection and national self-sufficiency.—Protection is sometimes advocated on the ground that it can be used for making a country economically self-sufficient. It may, however, be pointed out that those who are in favour of protection also favour encouraging exports by every possible means. But this is clearly incompatible with the ideal of self-sufficiency as imports must increase *pari passu* with exports. Apart from this consideration, it may be questioned whether national self-sufficiency is any more desirable an ideal than individual self-sufficiency. As Dr Edwin Cann n remarks, 'the superlative protectionist is the hermit who declines to buy anything from his neighbours'.[2] And a hermit nation is no more worthy of admiration than a hermit individual. Generally speaking, the ideal of self-sufficiency should be pursued only within the limits set by the principle of comparative cost, and protection thought of only in connexion with those industries in which a country possesses undoubted natural advantages.

The doctrine of national self-sufficiency is often supported from the standpoint of national defence. National safety, it is argued, requires that a country should aim a economic independence even if this should entail a permanent burden on the community. It may indeed be feasible and desirable to sacrifice economic considerat ons and to nurse certain industries for the avowed purpose of national defence. And yet it would be unwise to try to regulate the whole of the normal peace economy on a war basis. The fact that India is a huge country possessing varied resources brings self-sufficiency more within the bounds of practicability for her than, for example, for a country like Great Britain. But it is neither possible nor desirable

[1] *Fiscal Commission Report* (1924), par. 74.

[2] *Economic Journal* (March 1919), p. 79.

that she should be completely independent of other countries for the satisfaction of all her wants.

§3. **Strong sentiment for protection in India.**—The policy of free trade pursued by the British Government was particularly unpopular owing to the suspicion that the open door in India was favoured by England, not so much in India's as in her own interests. The way in which Lancashire was allowed to meddle from time to time with fiscal and industrial policy in this country strengthened this attitude of distrust. Further, the memories of bygone days, when India was renowned for her manufactures, added poignancy to the natural regret felt by patriotic Indians contemplating her insignificant position as an industrial nation. Other countries like the United States, Germany and, above all, Japan, appeared to have prospered exceedingly under, and because of, protection; and arguments, however plausible, that their prosperity was mainly due to quite other causes and that protection was rather an impediment than a help to their industrial development, failed to carry conviction. It was pointed out that England herself had discarded protection only when her pre-eminence in industry had been securely established and that anyhow the beginnings of the free trade regime in England had aimed at assisting industry by withdrawing protection from agriculture. Lastly, since 1915, England having herself drifted steadily into a policy of protection could not, with any grace, preach free trade to India.

The great increase of public expenditure after the war of 1914-18 had already compelled the Government to increase duties on imports—a procedure which was unintentionally protective as regards many manufactures. Such protection being 'casual and haphazard' was bound to carry with it certain undesirable consequences. It gave shelter without any assurance of a permanent policy, and not necessarily to industries which deserved it. High customs duties intended for revenue but accidentally protective may, instead of accelerating industrial development, actually hinder it, for example by taxing raw materials and semi-manufactured articles. These considerations may have facilitated the advent of conscious and deliberate protection in this country. However, it was not adopted as a kind of *pis aller*. Protection was introduced for the positive benefits expected from it and not merely as an escape from a system of unintentionally protective revenue duties.

§4. **Discriminate protection.**—The policy of Discriminate Protection as adopted in India professed to aim at giving the necessary stimulus to industrial development while minimizing the burden on the community. This involves granting protection only to industries which are proved to be suitable, and insistence on the adoption of efficient methods as one of the necessary conditions of admission to the benefits of protection.

The following general principles of discriminate protection, as enunciated by the Fiscal Commission, were adopted for guidance:

(i) The industry must be one possessing natural advantages, such as an abundant supply of raw materials, cheap power, a sufficient supply of labour, and a large home market.

(ii) The industry must be one which, without the help of protection, is either not likely to develop at all or is not likely to develop so rapidly as is desirable in the interests of the country.

(iii) The industry must be one which will eventually be able to face world competition without protection.

Other subsidiary suggestions are that industries subject to the law of increasing returns as well as those which promise, before long, to satisfy the entire needs of the country should generally be regarded as fit subjects for protection. On the other hand, as a general rule, an industry which can never meet more than an insignificant proportion of the home demand should not receive protection. Protection of one industry may possibly injure another; but it should not necessarily be refused to an industry on this ground, for there may be a net advantage on the whole.

Protection may sometimes have to be resorted to or increased as a measure against dumping. When dumping is clearly proved to exist and to be injuring some industry whose prosperity is a matter of national concern, a special dumping duty may be necessary. Similar action may be justified against the goods of a country whose currency is seriously depreciated, enabling it to export them at prices which are excessively low in terms of a relatively stable foreign currency. Lastly, bounty-fed articles coming from abroad may necessitate special measures of protection and there is already legal provision in this country for dealing with such a contingency. Act XIV of 1899 provides that 'where any country pays directly or indirectly any bounty upon export, the Governor-General-in-Council may, by notification in the *Gazette of India*, impose an additional duty on importation into India equal to the net amount of such bounty'.[1]

In the opinion of the Fiscal Commission the industries that will be found to deserve protection will generally be young industries. They recognize, however, that occasionally cases may arise where protection even to a strong and well-developed industry may be justifiable so as to enable it to recover from temporary depression due to causes beyond its control. For example, the protection granted from time to time to the cotton textile industry should properly come under this head since it can no longer be regarded as an 'infant industry' in India. No universal and dogmatic rule can, therefore, be laid down as regards the stage of development at which protection is justified.

In the case of absolutely new industries, however, the Fiscal Commissioners think that it would be running too great a risk to grant protection relying on 'the anticipations of the promoters' of the new venture rather than on actual facts. But, even in dealing with existing industries, it will not be possible altogether to avoid the traffic in anticipations and uncertainties. The speculative element would be greater when it is proposed to extend protection to an industry in order that it may develop some new branch, and yet the Commissioners do not look with disfavour on the policy of protecting an industry on this ground.[2] It is thus clear that the element of uncertainty will always be present in a greater or less degree in every case where protection is demanded. It may happen, however, that even in the case of an absolutely new industry, reliable data available in other countries

[1] Under the Safeguarding of Industries Act passed in April 1933 the Governor-General-in-Council was empowered to impose additional duties in all cases in which he was satisfied that foreign goods were being imported at such abnormally low prices as to threaten the existence of an established industry. The Act expired on 31 March 1935.

[2] See *Fiscal Commission Report*, par. 100.

where it has been securely established may be of such a character as to leave no reasonable doubt about its success here. The Fiscal Commission think that generally, in the case of new industries, protection will not only be objectionable but unnecessary, as the financial necessities of the Government will compel the retention of a general level of fairly high revenue duties and this will give all the protection that is necessary at the start. But this rather underrates the difficulties of making a start and loses sight of the fact that, in some cases, the beginnings may present far greater difficulties than the later stages of development and may require assurance of substantial help from the State before an industry, otherwise promising, can be started at all. The principle of the Government assisting new ventures by providing the necessary guarantees of minimum rates of interest for certain types of banks, which has been welcomed in most quarters, is not essentially different from the principle of giving consideration to them with a view to protection (see §14 below). The main point involved in each case is whether the industry satisfies the general conditions laid down above. However, the Fiscal Commission's suggestion, that bounties should be the rule rather than a protective tariff in the case of new industries, seems sound because so long as an industry is not supplying any considerable proportion of the total needs of the country, a protective duty will entail too heavy a burden on the consumer. Basic industries or 'key industries', i.e. industries whose products are utilized as raw materials which are indispensable for other important industries, have been recognized as deserving of special consideration. Among nationally important basic industries for India, the following are usually included: heavy chemicals, dye-stuffs, machine-tools, railway-wagons locomotives, aeroplanes, automobiles, paper, cutlery, hardware and electrical goods.

After deciding to grant protection to an industry, the next important question is to settle the rate of protection. The industry should not be protected so heavily that it ceases to exert itself any further. What is really wanted is a stimulant and not an opiate. The task of fixing upon a rate of duty that is just sufficient, and not too much or too little, is most difficult. It will be necessary to make sure that the relatively higher costs of production in India are not wholly due to inefficiency or other easily preventable causes. Again, for comparing the costs of production in India and foreign countries, average firms will have to be taken and not more than ordinarily efficient or more than ordinarily inefficient firms.[1] The rate of protection must also be considered in relation to the convenience of the consumer. A high rate may have the advantage of bringing about rapid development, but it may have to be low none the less, so as to prevent an undue rise of prices, and a comparatively slow development may have to be accepted as the lesser evil.

The adoption of the policy of discriminate protection has, according to some critics, led in practice to an indiscriminate refusal to protect on the part of the Government. If, however, it is true that the Government have been unduly cautious, the fault cannot be laid at the door of the principles of discriminate protection which are opposed not only to *too much* protection but also to *too little*

[1] To get an idea of the complexity of cost analysis, the reader should refer to Sir J. C. Coyajee, *The Indian Fiscal Problem*, pp. 36-7: V. G. Kale, *Economics of Protection in India*; C. N. Vakil and M. C. Munshi, *Industrial Policy of India with Special Reference to Customs Tariff*, pp. 82-5; and the various reports of the Tariff Board.

protection. The tendency towards an unduly strict and ungenerous interpretation of the principles of discriminate protection can no doubt be corrected to some extent by phrasing them somewhat differently. For example, the condition regarding the availability of abundant raw material within the country itself may either be omitted or waived in suitable cases. After all, England herself has to import cotton from other countries and yet her position in cotton manufactures, if no longer one of unchallenged supremacy, can still be described as pre-eminent. Further, in respect of this, and a number of her other prosperous industries, she relies largely on foreign markets.. The formula prescribed by the Fiscal Commission is therefore to be taken only as a general guide and not to be interpreted too rigidly or literally. The Tariff Boards set up from time to time, and more often the Government, have not always remembered this salutary caution. Another criticism of the actual working of discriminate protection in India is that it has permitted isolated consideration of each industry without reference to the problems of industrialization as a whole: this has acted as an irritating brake on development and given it a haphazard character.

The most important cause of the practical failure of discriminate protection in India was undoubtedly the lack of genuine sympathy on the part of the British Government with the goal of rapid industrialization. As Professor B. P. Adarkar remarks: 'Apart from protection, Western countries have through their governments taken active measures such as bounties, state aid, experimental and demonstrational undertakings, foreign trade commissions, industrial research, and active control and guidance of industrial concerns. The *discriminating protection*, on the other hand, has vouchsafed nothing better than a perfunctory assistance, indifferently and grudgingly rendered to industries whose subsequent development has been left to take its own course. Very often, the dilatory procedure adopted by the tariff machinery and by the Government has made the subsequent protection a veritable dead-sea fruit.'[1] Thus the problem of industrialization in India has for a long time been more political than economic and will be easier of solution now that political independence has been attained.

§5. Need for war-time adjustment of the policy of discriminate protection.— The recent war has brought into prominence the question of relaxing the conditions for the grant of protection laid down by the Fiscal Commission. In a Notification issued in June 1940, the Government of India announced that they were prepared to consider the question of assuring specified industries, the starting of which was considered essential under the conditions created by the war, of such measure of protection against unfair competition from outside India *after* the war as might be necessary to enable them to continue their existence. This notification had special reference to the grant of an assurance to the steel pipes and tubes industry. There was, however, a demand that industries not directly affected by the war, but for the starting of which the conditions created by the war were favourable, should also be given an assurance of protection after the war.[2] A period of general protection is likely as well as desirable in order to protect our industries against intense

[1] *Industrial Problems of India*, edited by P. C. Jain, pp. 93-4: Adarkar's article on 'Fiscal and Commercial Policy'.

[2] See *Journal of the Indian Merchants' Chamber*, September 1940.

foreign competition which will come sooner or later now that the war has ended and to prevent excessive dislocation due to the sudden withdrawal of protection. A Tariff Board has been engaged since 1947 in considering applications for protection from various industries and a number of them have already been granted protection.[1]

In the case of each industry, the Board is to examine whether it is established and conducted on sound lines; whether it is likely to develop, within a reasonable time, so that no further protection or state assistance should be necessary, and whether it is desirable in the national interest to extend protection or assistance to it; and whether this can be done without excessive cost to the community. The Board is also required to inquire as and when required by Government as to the cost of production of a commodity produced in the country and to report on its wholesale, retail or other prices; to recommend on measures necessary for the protection of industries from foreign dumping; to undertake studies, when required, on the effects of *ad valorem* and specific duties and tariff valuations on various articles and the effects of tariff concessions granted to other countries; to report, as and when necessary, on combinations, trusts, monopolies and other restraints of trade affecting or maintaining or raising prices, and to suggest ways of preventing such practices; and to maintain a continuous watch over protected industries.

Government also appointed a Fiscal Commission (1949) *inter alia* to review the policy of discriminate protection and assess its effects on the growth and development of India's trade and industry during the last 25 years. A new fiscal policy may be formulated on the basis of this review. The questionnaire framed by the Fiscal Commission covers broadly the following main points: (i changes in the economic background since 1922; (ii) the policy of discriminate protection and its application; (iii) review of effects of past tariff policy; (iv) principles of a revised tariff policy; (v) non-fiscal measures for the promotion of trade and industry; (vi) fiscal policy in relation to the Havana Charter on Trade and Employment; (vii) rights and obligations of assisted and protected industries; (viii) fiscal policy and preference.

§6. Dangers of protection.—The Fiscal Commission refer approvingly to Lala Harkishen Lal's maxim, 'Nurse the baby, protect the child and free the adult', as a good summary of correct principles of protection. The last part of this dictum, namely the freeing of adults, presents one of the toughest problems of protection, because the adult is apt to kick and otherwise make himself unpleasant if an attempt is made to 'free' him from the protectionist fetters which he finds very comfortable on the whole. When an industry comes under protection, it will naturally try to retain the advantage as long as possible, and one of the methods it may adopt is to disguise its prosperity and make a show of infantine helplessness. The other method is to bring political influence to bear upon the authority invested with the power of lessening or withdrawing the duty. To fix in advance a definite period for protection is not practicable, because if, in the meanwhile, conditions happen to change fundamentally, it will be necessary to reconsider the position and possibly extend the period of protection.

The Fiscal Commission express the view that the only way of maintaining

[1] A number of industries including cotton textiles, iron and steel, paper and pulp, magnesium chloride and sugar have also been removed from the category of protected industries.

satisfactory control would be for the Tariff Board to review periodically the position of the protected industry and make reasoned recommendations as to whether the duty should be continued or withdrawn and, if continued, whether the rate should be modified. It is necessary to choose the personnel of the Tariff Board with the greatest possible care. The success of the protectionist experiment depends on the manner in which this body works.[1]

In most countries which have adopted protection, tariff legislation is the resultant of the struggle of interested cliques and rarely follows a definite intelligent plan conceived in the interests of the country as a whole. The Fiscal Commission, however, point out that the danger of political corruption is not so great in India as in some other countries on account of the variety of interests represented in the legislature and the important position which the agricultural and landed interests will always occupy in the legislative bodies. This is perhaps taking an unduly optimistic view of the situation and underestimating the dangers of political corruption. The interests which prosper under protection will be able to command larger resources and better organization than the interests opposed to them, which would be too varied in character to combine effectively. The utmost publicity should be given to the investigations by the Tariff Board into the conditions of the industries soliciting special treatment. This would reduce the danger of corruption, provided the public is sufficiently instructed and vigilant. It would be highly desirable if consumers also learnt to organize themselves into powerful associations and helped to keep protection within legitimate bounds.

Besides political corruption, another evil to be guarded against is the development of combinations of manufacturers, which is stimulated by protection. Here again it would fall to the Tariff Board to make sure whether a combination that may have arisen is actually injurious to the country and, if satisfied that such is the case, to recommend diminution or withdrawal of protection.[2]

§7. **Essentials other than protection.**—India has adopted protection as an essential aid to the speedy development of industries. We cannot, however, merely legislate a nation into wealth and prosperity, and protection alone will not convert the medieval organization of a country into an up-to-date modern organization as it were by the wand of a magician. Even with protection, a country may remain for

[1] The late Professor N. S. Subba Rao in his Presidential Address at the Indian Economic Conference, Allahabad, 1929, suggested that India should have a National Economic Board on the lines of permanent bodies like the Tariff Commission and the Federal Trade Commission in the United States which make investigations as the result of a comprehensive plan of action. The Tariff Board may be suitably enlarged and allowed to appoint sub-committees and individual expert investigators. It should have power to make inquiries and surveys on its own initiative, and submit recommendations to the Government from time to time. This would replace the present hurried and piecemeal investigations, lead to orderly economic development and facilitate the necessary industrial adjustments in the country. Sir H. P. Mody suggested in March 1936 in the Assembly that the Tariff Board procedure should be revised to make it more speedy and effective as in the case of the Import Duties Advisory Committee in Great Britain.

[2] According to Dr Gyan Chand this evil has already appeared in India. 'Trustification of the industrial economy of India, limited as it is, is complete; a few score families have all the key positions and power in their hands, and this trustification is preeminently an achievement of British enterprise.'—*Industrial Problems of India*, p. 31.

ever economically backward in the absence of an adequate development of indispensable adjuncts of modern economic life such as an efficient banking organization, a developed system of transport, a sympathetic railway and shipping rates policy, an effective marketing organization, an efficient system of commercial and industrial intelligence, adequate command of capital, etc.

§8. **Education.**—Above everything else, what is required is a change in the mental outlook of all classes of people in India.[1] The diffidence and lack of enterprise which characterize the Indian people today are defects largely attributable to the present faulty system of education. From top to bottom our educational system is too literary and academic and it is necessary to give a more practical bent to it. A sensibly planned system of education will take particular care to emphasize the principle of the dignity of labour. 'Manual work, that is, creative manual activities of diverse kinds, should be part of the curriculum of every school.'[2] The prejudice against manual work to be found in India may be partly due to social reasons. But it is also largely explained by the fact that until recently the schools have been almost entirely without provision for manual activities of a satisfying kind for their pupils.[3] The Wardha Scheme of Education, based on Mahatma Gandhi's basic

[1] Asked by an old pupil what he thought of protection for India, Dr Alfred Marshall wrote:—'I have no objection on principle to the "protection" of nascent Indian industries. But a customs tariff is an expensive method to this end: and . . . I think it should not be applied until other methods have been tried, not until those industries which already receive *a very high* protection from cost of carriage (in some cases double cost of carriage) have succeeded in evoking Indian enterprise. Strong cases in point I understand to be the leather, paper and oil-seed industries. If India had a score or two of men like Mr Tata, and some thousands of men with Japanese interest in realities, with virile contempt of mere speech-making in politics and law courts; and with no scorn for work on *things* while the mind was full of *thoughts*, India would soon be a great nation. Nothing could stop her: no tariff could hinder her: she would enter into her heritage. But so long as an Indian who has received a high education generally spends his time in cultured ease; or seeks money in Indian lawsuits—which are as barren of good to the country as the sand of the seashore—nothing can do her much good; . . . For twenty years I have been urging on Indians in Cambridge to say to others: "How few of us when we go to the West think of any other aim save that of our *individual culture*? Does not the Japanese nearly always ask himself in what way he can strengthen himself to do *good service to his country* on his return? Does he not seek real studies? Does he not watch the sources of Western power? Is not that the chief reason for Japan's quick progress? Cannot we imitate her? Do we need any other change than, like the Japanese, to think of our country in the first place and ourselves as a long way behind?" '—A. C. Pigou, *Memorials of Alfred Marshall*, p. 472. It is doubtful if, had Marshall been living now, he would have written thus somewhat deprecatingly of the Indian sentiment in favour of protection. He would also probably have been fair-minded enough to admit that the comparison with Japan is misleading. The difference in the mental outlook of the Japanese and the Indians is due largely to the character of their respective governments. In Japan the state has helped by education and every other means to modernize the outlook of the people. In India the state under the British usually shirked its responsibilities in this connexion and while it often complained of defects in the national character as serious obstacles to industrial development it rarely did anything, except under irresistible pressure, to remedy these defects. The character of the people no doubt requires to be changed. But by far the most important means to this end is a government with a thoroughly national outlook.

[2] A. Abbott and S. H. Wood, *Report on Vocational Education in India*, p. 33.

[3] ibid., p. vi.

idea of imparting education in primary schools through some craft or productive work, is calculated to remedy the above defect of our educational system.[1] It is being tried out in several provinces and States.[2] One of the ideas in a sound scheme of education would be to make the scholar use his hands and eyes as much as possible. Lack of any education or of education of the proper kind not only makes the Indian workman inefficient and unreliable, but also kills in him all desire for self-improvement. Education will develop his wants, stimulate him to work more and better in order to satisfy them, and raise the whole tone of his life. One of the difficulties of Indian industries is that skilled labourers as well as supervisors and foremen have often to be imported from abroad. The men thus imported are naturally expensive and they have to be given a high scale of wages and, in addition to this, heavy expenditure has to be incurred in connexion with their repatriation. The Fiscal Commission recommended that the Government should make the training of apprentices one of the conditions of the tender when they place important orders with foreign firms. Besides skilled labourers, supervisors and foremen, it is necessary to have Indian managers. The system of state technical scholarships abroad can satisfy the need for the necessary training in this connexion only to a very limited extent. The only real solution is to start technical institutes of all grades in the country itself so as to make it possible for Indian industries to dispense with foreign labour of every kind. Research in industrial problems is a function of the highest importance and the necessary institutions for this purpose must be created and maintained. For industrial progress something more than mere technical knowledge is required. Men of insight, daring and organizing ability are necessary to lead the country in the industrial march and to enable it to keep pace with other nations. The multiplication of commercial colleges is likely to help men of this type to discover themselves. The present deficiency in this regard is at least partially due to the fact that our educational system has not hitherto made it its special business to foster the qualities required for making a successful business man. The excessively literary character of the education, which was originally intended merely to provide for the administrative needs of the Government, has been in some measure mitigated in recent years by the increasing importance given to the teaching of modern science in our schools and universities. The personal contact with specific realities and the exercise in verifiable reasoning which the laboratory makes possible help in turning the thoughts and actions of men into useful practical channels. Commercial and technical schools and colleges ought also to have the same desirable effect. The increasing keenness of the struggle for existence is gradually forcing the educated classes to seek careers in business rather than in Government service, which cannot possibly provide for an unlimited number of graduates. The attractions of Government service and the overcrowded professions (e.g. the profession of law) will diminish when other openings are offered by the development of industries. All these changes must come far more rapidly than at present, and for this heroic efforts are necessary.

§9. **The position of industrial education in India.**—For a long time the Victoria Jubilee Technical Institute, started in 1877 in Bombay, chiefly through private

[1] *Report of the Zakir Husain Committee*, Section I.

[2] C. J. Varkey, *The Wardha Scheme of Education*, 2nd ed., ch. ix.

efforts to provide courses of instruction suitable to the needs of the growing local mill industry, was the only institution of its kind in the country. The investigation into the defects of the educational system of India set on foot by Lord Curzon, who called a conference of educational experts at Simla in 1901, raised prominently the question of technical education, but the only practical outcome of this was some improvement in the teaching of science at the universities and the institution of a number of technical scholarships by the Government of India to enable Indians to proceed to England and America. This system however failed to produce satisfactory results.

In recent years the question of technical and general education has bulked largely in public discussions. It got detailed attention at the hands of the Industrial Commission (1916-18), the Calcutta University (Sadler) Commission (1917-19), committees appointed by the Government of Bombay in 1921 and 1938, the Zakir Husain Committee appointed by the Wardha Education Conference (1937)[1] and from Messrs Abbott and Wood, educational experts from England (1937).[2] The Industrial Commission made a number of recommendations for (i) the provision by local Governments and authorities of a suitable system of primary education with an industrial bias for the artisan and labouring population, including subsidizing such employers of labour as might undertake to supply educational facilities for the benefit of their employees; (ii) provision of industrial or craft schools under the control of the Department of Industries for cottage industries; and (iii) provision for the training of men for organized industries. These were divided into the manipulative industries such as mechanical engineering, and non-manipulative or operative industries, such as the manufacture of chemicals. The training for the foremen was to be given in the works themselves, to which theoretical classes were to be attached, though in some cases, such as the textile trade, in technical schools with workshops attached to them. For the operative industries technological schools were to be supplemented by practical experience in the factory. In addition to the existing provincial institutions the Commission recommended the establishment of two Imperial Colleges, one for the highest grade teaching of engineering, and the other for metallurgy and mineral technology.[3]

Under the 1919 Reforms, education became a provincial transferred subject, the promotion of industrial and technical education being controlled by the Provincial Departments of Industries. But owing to financial stringency, no solid results have so far been achieved. Even primary education is making very slow progress in spite of the enabling and compulsory Primary Education Acts that have been passed in several provinces and the raising of the age of employment of children in factories by the Factory Act of 1922.[4] Recognizing the necessity of a wider

[1] See vol. I, ch. viii, § 2. [2] See next section.

[3] The Indian School of Mines at Dhanbad was opened at the end of 1926 and is intended to serve as a training ground for mining engineers and geologists.

[4] The Provincial Governments were however left with substantial financial resources at the end of the recent war and were expected to initiate a vigorous drive for the rapid extension of education. For example, the Government of Bombay, while accepting the need for introducing a seven-year course of elementary primary education on a free and compulsory

extension of technical education and industrial training, the Government of Bombay appointed a committee on technical and industrial education in February 1921. The committee produced two reports, one by the European majority and the other by the Indian minority (the President, Sir M. Visvesvaraya, supporting the minority), the main points of difference between the two sections being in regard to types of institutions, number of pupils to be trained and estimates of cost, and organization and agencies for carrying out the scheme.

No action however was taken even on the limited scale contemplated by the Majority Report, though the weaving schools maintained by the Department of Industries continue to help the hand-loom industry. Thus the position in regard to general, technical and commercial education remained unsatisfactory and the actual provision that has been made by Government or private effort could scarcely be called adequate considering the huge size and large requirements of the country. Also, as the Hartog Committee remarked, such attempts as were made to provide vocational and technical training had little contact with the educational system and were therefore largely infructuous.

§10. **Abbott-Wood Report.**—At the invitation of the Government of India two educational experts from England, Mr A. Abbott and Mr S. H. Wood, visited India in November 1936, in order to advise on educational reorganization, particularly on problems of vocational education, and submitted their Report in June 1937. The following are some of their recommendations:

(i) The education of children in the Primary schools should be based more upon the natural interests and activities of young children and less upon book learning.

(ii) The Indian languages should, so far as possible, be the medium of instruction throughout the High (or Higher Secondary) schools, but English should be a compulsory language for all pupils in these schools.

(iii) The expansion of vocational education should not greatly outstrip the development of industry. If vocational education is not too specialized and if it aims at cultivating flexibility of mind and certain personal qualities which are as much moral as intellectual, industry and commerce should be able to absorb a somewhat larger proportion of trained men than an exact computation of their existing needs would appear to justify.

(iv) Every province should make a survey of the educational needs of its industries and commerce and thus determine the type of vocational education to be provided, and especially the number of recruits that can be absorbed annually.

(v) Industry and commerce must co-operate with educational organizations if the vocational education is to be appropriate and adequate. Organized co-operation of this kind does not yet exist in India.

basis, as recommended by the Central Advisory Board of Education, recently (October 1946) decided, as an immediate step, on the introduction of compulsion in villages with a population of 1,000 and over and in all towns, subsequently to be extended to all other areas. The Government have also accepted the principle of education through purposeful activity and have decided immediately to introduce craft training in all primary schools and basic training for all primary teachers. The Government will further establish Lokashalas themselves and encourage their establishment by Local Boards and other institutions with a view to ensuring the supply of better qualified teachers for primary schools.

(vi) It is the supervisory grade of workers, i.e. foremen, charge-hands, etc., on whose education and training great attention should be concentrated at this stage in the development of organized industry in India, since they hold the key to efficiency in production.[1]

§11. **Supply of technicians for war industries.**—A Technical Training Scheme was initiated by the Government of India in 1940 with a view to meeting the war needs of the country and to creating a nucleus of trained technicians to help the industrial development of India.[2]

In order to meet the requirements of ordnance factories and civil industry for skilled machine-tool artificers and tool-makers, a new scheme was prepared, under which carefully selected trainees were allotted to firms engaged in civil industry for advanced training and subsequent employment in ordnance factories or civil industry.[3]

Mention may also be made here of the Bevin Training Scheme (Bevin Boys' Scheme) for industrial training of Indian workmen in the United Kingdom which was linked up with the Government Training Scheme in the United Kingdom started to overcome the shortage of skilled workmen in England for war purposes and to train the so-called 'green' labour for war industries. Another idea underlying the scheme was to bring the Indian workman into close contact with British labour and thus to help in promoting a strong and well-organized labour movement in India similar to that in England. The Indian workman was also expected to come back with a wider cultural, social and educational outlook. Candidates were selected from among factory workmen in India and sent at Government expense for training in England. On arrival in England they spent two or three months in a Government training centre, from where they went on to industrial factories to gain training in specialized engineering trades along with first-hand experience of Britain's war production. They were distributed in such factories as were likely to be most useful to them after their return to India. The total period of training was eight months. On return to India the trainees were subjected to a test, after which suitable jobs were found for them.[4] With the end of the war, however, the Bevin Boys began to find it difficult to secure suitable employment in private industry.

§12. **Stores purchase policy.**—The various public departments as well as the railways in the country purchase immense quantities of stores of all kinds, many of which were till recently imported from abroad, mostly from England, through the Stores Department of the India Office, London. One way of encouraging industries would be to make purchases of Government requirements as far as possible within the country. Like many another excellent principle this was also recognized long ago without being translated into action. About fifty years ago, the Government enun-

[1] Abbott and Wood, op. cit., ch. xiv.

[2] After 1937-8, the Government of Bombay worked out a scheme for recruiting apprentices and sending them for training in technical subjects to Bombay or Ahmedabad in mills, workshops, presses, and chemical or other firms. These trained apprentices were utilized largely for employment in the various war departments as Supervisors and Assistant-Supervisors.

[3] See *Indian Labour Gazette*, August 1943, p. 29.

[4] The Government of India carried out certain other training schemes also. One of these was to train craftsmen in skilled work in India itself, some outstanding men among whom were sent abroad for higher training.

ciated the policy of purchasing, for State use, stores of Indian origin or manufacture rather than stores produced or manufactured abroad. Rules, which were revised from time to time, were also made governing stores purchase, under which preference was to be given to articles wholly or partially manufactured in India, subject to certain conditions as regards quality, etc. In cases where the articles available in India are as good as can be had elsewhere and are as cheap as elsewhere, it goes without saying that preference should be given to indigenous goods. There are some who would go even further than this and would have articles of home manufacture preferred even if they were to cost considerably more. Such a policy would entail an increased burden on the taxpayer and would, strictly speaking, amount to a grant of protection. Before action is taken under it in favour of a particular industry, involving considerable increase of public expenditure, opportunity might well be given to the Tariff Board to express an opinion on the matter. In any case, the question would require to be considered in the light of the principles of protection as outlined above. In actual practice, according to the finding of the Industrial Commission, preference was given to British stores even when they could have been supplied equally well both as regards price and quality by Indian manufacturers, who were handicapped in various other ways in meeting the demands of the Government departments when competing with tenders received by the India Office Stores Department in London. An attempt to excuse, if not justify, the Government's failure to avail themselves of the stores purchase rules and to utilize fully the manufacturing capacity of the country was made by pointing out that there was no suitable inspecting agency to direct and advise the indenting officer in India, who relieved himself of all trouble and responsibility by sending orders to the India Office Stores Department in London. The explanation provoked the query why steps were not taken to provide the requisite agency for obtaining expert advice. The idea that it was possible to regulate the purchase policy in such a manner as to stimulate Indian industries was endorsed by the Indian Industrial Commission. Even if the policy of 'fair field and no favour' is adopted, without what we may call protective preference being shown to Indian manufactures, the advantage of securing the large custom of the Government would in itself act as a healthy and valuable stimulus. Also, as the Industrial Commission have pointed out, if certain suggestions for improving the method of placing orders were accepted, not only would existing industries benefit, but also new industries might be started. For example, if instead of allowing unnecessary diversity in orders for the same kind of goods, standard patterns were adopted, it might be profitable to put down special plant in India in view of the large demand for goods of a standard type which would thus result.

With the progress of industrial development it is becoming more and more possible for the Government to have their needs supplied by local industries, particularly as arrangements have now been made for removing the difficulty arising from lack of information as to sources and market values of Indian supplies and the absence of an inspecting agency. The Stores Purchase Committee (1921) appointed in accordance with the Industrial Commission's recommendation supported the latter's suggestion that a central expert agency for the purpose of inspecting Government stores should be established. The Indian Stores Department was instituted accordingly, and though it is intended primarily to serve the Government of India,

it is open to the Provincial Governments, municipalities, Port authorities, company-managed railways and other public or semi-public bodies and Indian States to avail themselves of its services. The Department acts in an advisory capacity as a purchase and inspection agency, scrutinizes the indents with a view to preventing orders being placed abroad when purchases of goods of indigenous origin are possible, subject to conditions of price and quality, purchases and inspects certain specified commodities in India, acts as a central bureau of information on all matters connected with the purchase and prices of stores, and discharges other important functions so as to encourage Indian industries. Local purchasing branches have been created at Calcutta and Bombay, and inspection agencies at Madras, Bombay, Cawnpore and Delhi. For the convenience and encouragement of Indian firms competing with foreign firms, the Department has adopted and is progressively developing the policy of inviting rupee tenders for delivery in India. In order to ensure the successful working of the rupee tender system, the consulting engineers to the High Commissioner in London have been appointed expert advisers and have opened a branch office in Calcutta for that purpose. An important part of the work of the Stores Department consists of making continual investigations into the potentialities of indigenous sources of supply, resulting in a constant enlargement of the list of approved contractors in India.

The creation of the Supply Department during the recent war resulted in a substantial increase of purchases made in India by the Government.

§13. **Industrial research.**—The Fifth Industries Conference of July 1934 considered a proposal to establish a Central Industrial Intelligence and Research Bureau with a view to the co-ordination of research. The Bureau, now called the Industrial Research Bureau, was established in April 1935 with a research branch at Alipore. The Bureau, which is given the assistance of an advisory body, called the Industrial Research Council, is attached to the Indian Stores Department. Its functions are: collection and dissemination of industrial intelligence, collaboration with industry in industrial research, publication of appropriate bulletins giving advice with a view to industrial standardization, and assistance in the organization of industrial exhibitions. The need for such a central agency and the value of industrial research can hardly be exaggerated. A new body, called the Board of Scientific and Industrial Research, has recently been set up. Representatives of the principal industries are associated with the Board, which at its meeting held in Bombay in September 1940 discussed several schemes to tackle the problem of industrial deficiency in India during the war period, with special reference to the production of vegetable dyes, heavy chemicals, utilization of vegetable oils to make up for the loss of export markets for India's oilseeds, etc. The Government of India is proposing to establish eleven National Laboratories in various parts of the country at a total capital expenditure of Rs. 380 lakhs.

§14. **Work of Provincial Departments of Industries.**—We have already referred to the establishment of the Provincial Departments of Industries as recommended by the Industrial Commission.[1] The main work of these departments falls under three classes: (i) promotion of technical and industrial education; (ii) supply of industrial intelligence; and (iii) assistance to industries, financial as well as by

[1] See vol. I, ch. xiii, §4.

means of arts and crafts depots and industrial exhibitions. Their activities are, however, largely devoted to the development of cottage and rural industries rather than to large-scale industry.[1] Success on the lines and scale anticipated by the Industrial Commission has not been achieved by the Departments of Industries because of want of funds and the great change, since the time of the Industrial Commission, in industrial conditions. The constitutional changes of 1919 and 1935, by which responsibility for industrial development devolved largely on the provinces, have also handicapped the adoption of a systematic and comprehensive industrial policy. A certain amount of useful co-ordination has, however, been effected through the annual sessions of the All-India Industries Conference which are attended by the Provincial Ministers and Directors of Industries and also representatives of some Indian States. Comparatively greater success has attended the efforts of the Bengal Industries Department, which with its fully adequate staff and after the opening of a research laboratory in Calcutta, may be regarded as well equipped to carry out the policy recommended by the Industrial Commission. The Industrial Chemist in that province concerns himself with investigations relating to the better utilization of raw materials available in Bengal. The Bengal Tanning Institute is doing research work on problems connected with local leather and tanning. We may also mention the industrial surveys carried out in the United Provinces, Bengal, Madras and Bombay. Demonstration factories have been started in some provinces. But unfortunately only a few of them, as for example, the manufacture of ink in Madras have proved successful; others like bobbin manufacture in the United Provinces have failed.

We have already referred to the Acts passed by some of the Provincial Legislatures for giving financial assistance to industries. These Acts have been in force in Madras, the Punjab and Bihar and Orissa since 1923. Similar Acts passed in Bengal and the Central Provinces became law in 1931 and 1933 respectively. In Bombay, the State-Aid to Small Industries Rules (1935) having been found inadequate, new rules have been framed pursuant to a Resolution passed by the Bombay Legislative Assembly. These rules provide for various forms of State aid, including guarantee of interest on shares or debentures, taking of shares and debentures, grant of a loan, subsidies for research work, etc. Under the State-Aid to Industries Acts, loans can be given to private enterprises for starting new industries subject to certain conditions. In actual operation these Acts have been of greater use to small, rather than to large-scale industries.[2] The failure of the few big loans given to large concerns like the Carnatic Paper Mills (Madras) and the Indian Steel Wire Products Ltd (Bihar) only serves to emphasize the need for special measures to solve the problem of financing large industries.

The Report of the Madras Department of Industries for the year ending March 1935 confessed that during the twelve years that the State-Aid-to-Industries Act had been in force, it could not claim to have achieved any measure of success in stimulating industrial development, and suggested that, following the example of the United Provinces, a special committee should be set up to formulate a

[1] These activities are reviewed in the chapter following.

[2] See *Proceedings of the Fifth Industries Conference* (1933), and D. R. Gadgil, *Industrial Evolution of India* (fourth edition), p. 325.

new scheme of financial aid to industries. The Committee in the United Provinces known as the Industrial Finance Committee had been appointed in 1934 under the chairmanship of the late Sir S. N. Pochkhanawala. This Committee held that direct State aid to industries was not desirable. It recommended the establishment of a joint bank called 'The United Provinces Industrial Credit Bank, Limited', with a capital of Rs. 25 lakhs, with a Government guarantee for a maximum period of 20 years of a 4 per cent dividend on the shares free of tax in order to provide long-and short-term credit to major and minor industries. The Committee also suggested the starting of a new marketing organization to be called 'The United Provinces Financing and Marketing Company, Limited' run on joint-stock lines with a capital of Rs. 5 lakhs, to be underwritten by the Industrial Bank.[1] The United Provinces Legislature approved of the Government's scheme, drafted generally in accordance with the Committee's recommendations, in June 1936.[2] The Bengal Legislature also approved the establishment of an Industrial Credit Corporation in December 1936. It is meant to provide loans for the establishment of small-scale industries by released detenus and by any Bengal citizen who can put forward a feasible proposition.[3]

§15. Planning and industrialization.—Many causes, of which the U.S.S.R. experiment is not the least important, have recently intensified the feeling in India that purposeful and systematic planning on the part of the Government is necessary to bring about a satisfactory development of modern industry together with a general economic revival in the country. In September 1943, Sir M. Visvesvaraya put before the All-India Manufacturers' Organization a programme for post-war reconstruction in India involving, in the course of a few years, an investment of Rs. 1,000 crores in basic industries, productive public works and public utility undertakings, doubling agricultural and industrial production, provision for greatly extended facilities in banking, tariff protection with relaxation of duties on imported machinery, preferential treatment for heavy industries, annual planning, etc.

Eight prominent Indian business men issued in 1944 Part I of what they called *A Brief Memorandum Outlining a Plan of Economic Development for India.* This is now generally known as the Bombay Plan.[4]

The principal objective of the Plan was to bring about a doubling of the present per capita income within a period of fifteen years. Allowing for an increase in population of 5 millions per annum, a doubling of the per capita income within 15 years will necessitate a trebling of the present aggregate national income. To achieve this result it was proposed to raise the net output of agriculture to a little over twice the present figure and that of industry, including large and small industries, to approximately five times the present output.

[1] *State Action in Respect of Industries*, 1928-35, p. 42.

[2] Further particulars of this scheme are indicated in the sections dealing with Industrial Finance in the chapter 'Banking and Credit'.

[3] For fuller details see N. Das, *Industrial Enterprise in India*, pp. 138-40.

[4] So called because with one or two exceptions the authors of the Plan are Bombay men. The authors are Sir Purshotamdas Thakurdas, J. R. D. Tata, G. D. Birla, Sir Ardeshir Dalal, Sir Shri Ram, Kasturbhai Lalbhai, A. D. Shroff and John Matthai.

The total capital requirements of the Plan would amount to about Rs. 10,000 crores distributed as follows:

Industry	Rs. 4,480 crores	Health	Rs. 450 crores
Agriculture	,, 1,240 ,,	Housing	,, 2,200 ,,
Communications	,, 940 ,,	Miscellaneous	,, 200 ,,
Education	,, 490 ,,	TOTAL ..	Rs. 10,000 crores

The threefold increase in the national income which was aimed at involved the following increments in the net income from industry, agriculture and services.

	Net income in 1931-2 (*Rs. crores*)	Net income expected after 15 years (*Rs. crores*)	Percentage increase
Industry	374	2,240	500
Agriculture	1,166	2,670	130
Services	484	1,450	200

The industries were classified into two principal categories: (i) basic industries; and (ii) consumption goods industries.

Among the most important basic industries which would receive priority in the earlier years would be the following: Power—electricity; Mining and Metallurgy—iron and steel, aluminium, manganese; Engineering—machinery of all kinds, machine tools; Chemicals—heavy chemicals, fertilizers, dyes, plastics, pharmaceuticals; Armaments; Transport—railway engines and wagons, shipbuilding, automobiles, aircraft; Cement.

Typical consumption industries to be further developed are: Textiles—cotton, silk and wool; Glass industry; Leather goods industry; Paper industry; Tobacco industry; Oil industry.

Small-scale and cottage industries were to be provided for along with large-scale industries as a means of affording employment and of reducing the need for capital, particularly of external capital in the early stages of the plan.

The total estimated amount of capital required for increasing agricultural production to the target figure is shown below:

	Non-recurring expenditure (*Rs. crores*)	Recurring expenditure (*Rs. crores*)
Soil conservation, etc.	200	10
Working capital	..	250
Irrigation—canals	400	10
,, wells	50	..
Model farms	195	130
TOTAL ..	845	400

The total cost of increasing rail and road mileage and improving ports was expected to be:

	Non-recurring expenditure (*Rs. crores*)	Recurring expenditure (*Rs. crores*)
Railways	434	9
Roads new construction	300	35
,, —reconstruction	113	..
Ports	50	5
TOTAL ..	897	49

The proposed sources of finance were as follows:

External finance—

Hoarded wealth	Rs. 300 crores		
Sterling securities	,, 1,000 ,,		
Balance of trade	,, 600 ,,		
Foreign borrowing	,, 700 ,,	Rs.	2,600 crores

Internal finance—

Savings	Rs. 4,000 crores		
'Created money'[1]	,, 3,400 ,,	Rs.	7,400 crores
TOTAL ..		Rs.	10,000 ,,

For purposes of execution it was proposed that the Plan should be subdivided into three 5-year plans, the expenditure to be incurred being as shown below:

	First plan (*Rs. crores*)	Second plan (*Rs. crores*)	Third plan (*Rs. crores*)	Total (*Rs. crores*)
Industry	(790)	(1,530)	(2,160)	(4,480)
Basic industry	480	1,200	1,800	3,480
Consumption goods industry ..	310	330	360	1,000
Agriculture	200	400	640	1,240
Communications	110	320	510	940
Education	40	80	370	490
Health	40	80	330	450
Housing	190	420	1,590	2,200
Miscellaneous	30	70	100	200
TOTAL ..	1,400	2,900	5,700	10,000

The second part of the Bombay Plan, which was published in January 1945, set out certain general ideas on the problem of distribution and advocated equitable distribution of the increased wealth resulting from the execution of the Plan. It aimed at reducing inequalities of wealth and providing a minimum standard of living for all. It advocated the use of direct taxes like death duties on surplus income or capital at progressive rates, together with a differentiation between earned and unearned incomes, reform of land-tenure and widespread distribution of shares in joint-stock companies. It visualized full employment for the entire population

[1] Created money means money created against *ad hoc* securities, i.e. on the inherent credit of the Government.

of working age with progressive improvement in the level of industrial as well as agricultural wages. Suggestions were also made for decentralizing industry and its regional distribution in due subordination to the master-plan. The need for the encouragement of cottage and small-scale industries was recognized and a judicious combination of State and private enterprise was urged. 'The triple broad principles by the Bombay planners were: (*a*) necessity of orderly development out of the pre-existing economic set-up, (*b*) economy of central control, and, finally, (*c*) in consonance with the social and distributive ends of the community, maximum decentralization of the means of production as well as of actual productive units, subject to the overriding consideration of the economies of large-scale production in industry and agriculture.'[1]

If we assume total mobilization of our national resources and complete and sustained co-operation between the Government and the people, reconstruction on the scale visualized by the Bombay Plan need not be regarded as impossible. But it will necessarily involve great sacrifice on the part of the people during the process of capital-formation which must precede production of consumers' goods by modern methods. India being a very poor country with an extremely low standard of living among its people, sacrifice of present consumption for the sake of capital accumulation will undoubtedly be a very difficult matter. The Bombay Plan has now become out of date and needs detailed revision in the light of developments since it was prepared, such as the great rise in prices of commodities and equipment. The figure for necessary capital expenditure to put the Plan into operation would now (1950) be nearer Rs. 30,000 crores than Rs. 10,000 crores. Moreover owing to the present financial stringency, Government will have to be content with something more modest involving much smaller outlay of money and quicker returns.

Since the National Planning Committee was set up in 1938, there has been a plethora of plans, official as well as non-official. The task before the government at the centre[2] will be to co-ordinate and perfect the different schemes that have been put forward, settle the priorities and implement the plan systematically in the light of clearly conceived objectives and targets.

When the Congress went into the wilderness shortly after the declaration of the war in 1939, the work of the National Planning Committee practically came to a dead stop. After an interval of five years the Committee met in September 1945. In view of the fundamental change in economic conditions during the war, the Committee issued revised instructions to its various sub-committees. However, owing to inadequate finance and administrative machinery and absence of full statistical data, the Committee found it impossible to draw up plans which could really be called blue-prints, and its proposals and conclusions afford only general guidance and information.

[1] *The Eastern Economist*, 26 January 1945, pp. 95-6.

[2] The Planning and Development Department of the Government of India was wound up after a short existence, following the appointment of the 'Caretaker' Government in 1946, and its activities and sections were distributed among the other Departments. During its brief career, especially under the dynamic leadership of Sir Ardeshir Dalal, the Department did valuable work in laying down policies.

CHAPTER II

INDIAN INDUSTRIES: OLD AND NEW

§1. Scope of the chapter.—Indian industries may be divided into two classes (i) industries carried on with hand-operated appliances in the home of the worker, which may be called cottage industries. Here the scale of operations is small, organization limited and production intended largely to supply local needs. We shall discuss these cottage industries at the end of this chapter. (ii) Organized industries with power-operated machinery, carried on in workshops or factories which vary in size from simple rural factories performing a single operative process to the large textile mills and engineering workshops employing thousands of hands and possessed of a complete organization, both for manufacture and trade.[1] Organized industries connected with agriculture—such as the tea, coffee, indigo and sugar industries—have been already treated under agriculture.[2] We shall now first of all attempt a description of the principal organized industries of the new type in India. This will give us some idea of the advance in industrialization already made, and incidentally throw light on the manner in which the new protective system is being applied under the guidance of the Tariff Board.

§2. The cotton mill industry.—We shall now proceed to give a short account of some of the large-scale industries in India. The first cotton mill in India was erected at Calcutta in 1818. The first mill in Bombay, which was destined to be the home of the cotton mill industry, was the result of Parsee enterprise and began working in 1854.

The early concentration of the industry in the Bombay island was governed not so much by natural and permanent factors as by other advantages, such as abundance of capital and credit facilities, the presence of cheap and speedy means of transport and the temporary growth of the demand for yarn from China, which Bombay was in an exceptionally favourable situation to meet. The year 1877 marks the turning-point in the development of the industry from the point of view of its distribution. It saw the beginning of a rapid construction of mills in up-country centres like Nagpur, Ahmedabad, and Sholapur, situated in the heart of the cotton-producing tracts. This later distribution was influenced to a very much larger extent by natural factors, such as the vicinity of sources of raw material, plentiful labour and large marketing centres, and was made possible by the deve-

[1] In recent classifications of Indian industries, the organized industries are further sub-divided into two categories: small-scale industries and large-scale industries. For instance the Bombay Industrial and Economic Survey Committee observes: 'By small-scale industries we understand industries where power is used and where the number of workers does not exceed 50 and the capital invested is less than Rs. 30,000, e.g. motor-repairing, oil-pressing, hosiery, watch-manufacture, soap-making, rice and flour mills, etc. Large-scale industries are those where power is used, and the number employed exceeds 50 and the capital invested is above Rs. 30,000, e.g. cotton mills, sugar factories, paper mills, etc. (*Report*, pars. 15-16)'. The National Planning Committee also divides Indian industries into three classes: cottage industries, small-scale (or medium-sized) industries, and large-scale industries.

[2] See vol. I, ch. vi.

lopment of railway communication. The decline of the China trade in yarn from the commencement of the present century also affected adversely Bombay's position of unequalled pre-eminence. The swadeshi movement, moreover, stimulated the growth of weaving outside Bombay province. The developments in factory legislation in British India also set up a tendency for the migration of the industry to some of the Indian States where the administration of factory laws was more lax.

Recently, there has been a tendency on the part of the Indian mills to increase the manufacture of finer counts, and a certain amount of long staple cotton is imported from the U.S.A. and elsewhere for this purpose. But the spinning of finer counts is limited by the expensiveness of foreign cottons and of the new machinery which has to be laid down. An improvement in the quality of the home-grown cotton will help the situation.

The cotton industry received a considerable stimulus during the war of 1914-18. The large patronage extended to the mills by the Government in respect of their military requirements in cotton goods in the eastern theatres of the war, together with the shrinkage in imports and the sharp rise in the prices of imported cloth due to shortage of shipping, led to a considerable increase in home production, though the difficulty of importing machinery prevented as speedy a development as would otherwise have taken place. World War II witnessed a phenomenal expansion of the cotton textile industry, the factors responsible for this expansion being the shrinkage of imports, the increase in exports, the expanding volume of war orders, increased domestic demand and, for some time at the beginning of the war, a favourable labour situation.

§3. **Growth of the cotton mill industry.**—The following table brings out the progress made by the cotton mills in the whole of India and the decline in the imports of piece-goods.

TABLE I

Year	No. of mills	No. of spindles	No. of looms	Average no. of hands employed
1900	193	4,945,783	40,124	161,189
1914	271	6,778,895	104,179	260,276
1918	262	6,653,871	116,484	282,227
1922	298	7,331,219	134,620	343,723
1936	379	9,856,658	200,062	417,803
1939	389	10,059,370	202,464	441,949
1942	396	10,026,425	200,170	480,487
1943	401	10,130,568	200,890	502,650
1948*	422	10,433,065	202,072	476,145.

Mill production in India was 678 million yards in 1904-5, while the figure for 1943-4 was 4,870 million yards.

The continuous progress of the export trade in yarn till 1904-5 was due to the geographical advantage enjoyed by Bombay with respect to the Chinese market.

* Includes Pakistan.

The mills in the Bombay island supplied more than ninety per cent of the total exports, of which China absorbed ninety per cent. Japan was another important customer till the year 1890. New markets had also been developed in the Straits Settlements and Arabia. After 1905 the trade declined as rapidly as it had developed before. The principal factors that led to the decline were the disturbance in the exchange rates with China consequent upon the closing of the Indian mints to the free coinage of silver, the rise of the spinning industry in China, the shipping difficulties of the Indian merchants caused by the war which gave to Japan her coveted opportunity, the growth of weaving in India itself, and the neglect of foreign markets on the part of Indian producers due to the large internal profits. It may be noted that Japan did not appear as a rival to India in the Chinese market for yarn till after the outbreak of the 1914-18 war. Since then, however, not only did she succeed in ousting India from the Chinese market but the imports of Japanese yarn into India itself increased with alarming rapidity and seriously affected the prosperity of our spinning industry. The exports of cotton twist and yarn declined from 244 million lb. in 1899-1900 to 193 million lb. (average of five years before 1914); to 130 million lb. (war average of five years); to 82 (post-war average of five years); and to 38 million lb. in 1938-9. In the same year the total Indian mill production of yarn was as much as 1,303 million lb. Thus India now exports only a small percentage of her yarn production, practically the whole of it being absorbed in the country itself. Since the beginning of the present century there has been a remarkable expansion in the weaving industry stimulated by the virtual extinction of the China trade in yarn, and consequently our reliance on foreign cloths has diminished considerably.

Causes connected with the war led to the memorable boom which started in 1917. The capital investments in the industry increased from Rs. 20·84 to Rs. 40·98 crores between 1917-18 and 1921-2. Under the influence of soaring prices the mills were working to their full capacity. The Bombay cotton mill industry paid very high dividends amounting to 40·1 per cent of the paid-up capital in 1919; 35·2 per cent in 1920; and 30 per cent in 1921.[1]

The boom lasted for a period of six years at the end of which the crash came. In the meanwhile, Japan had stolen a march over us not only in the Chinese market but had also begun to pour cheap goods into India, which forced down the prices of goods produced in Indian mills. India had to participate in the world depression as it did in the world boom. Other world factors were the altered relations between agrarian and general prices since 1920 and violent fluctuations in the prices of cotton since 1917. The general depression in industry all over the world was the result of the reduced purchasing power of the agrarian classes due to the fall in world agricultural prices since 1920. The extensions planned during the boom period were not completed before 1922. 'The new concerns started had, of course, incurred capital expenditure at the boom level of prices and these high capitalized charges were still further increased in most cases by the turn that exchange took in 1920.'[2]

[1] See *Report of the Tariff Board* (Textile Industry), 1927, Appendix V and Brij Narain, *Economic Life in India*, p. 458.

[2] See Gadgil, op. cit., p. 250.

Violent fluctuations in prices of cotton in India affected by the American prices and supplies of cotton since 1917 further increased the embarrassments of the cotton industry in India. Probably the worst year for the industry was 1923, especially in Bombay, its principal centre (see §7 below).

§4. **Per capita consumption of cotton piece-goods in India.**—The table[1] below gives interesting figures relating to the consumption *per capita* of cotton piece-goods, including hand-loom products, in India.

Year	Net imports[2]		Net available mill production[3]		Hand-loom production		Net available for consumption	
	Actual	*Per capita*	Actual	*Per capita*	Estimated	*Per capita*	Total	*Per capita*
	Yards (crores)	Yards	Yards (crores)	Yards	Yards (crores)	Yards	Yards (crores)	Yards
1905-6	239	7·97	61	2·03	108	3·60	408	13·60
1923-4	142	4·30	154	4·67	101	3·06	397	12·03
1936-7	79	2·13	347	9·38	149	4·03	575	15·54
1937-8	58	1·57	384	10·38	149	4·02	591	15·97
1938-9	63	1·66	409	10·76	192	5·05	664	17·47
1939-40	56	1·47	379	9·97	182	4·79	617	16·23
1940-1	40	1·02	388	9·95	165	4·23	593	15·20
1941-2	10	0·26	372	9·54	207	5·30	580	15·10

In calculating *per capita* consumption, variations in population from year to year have been allowed for. It has not been possible to take into account exports by land, and stocks left from year to year. The figures for hand-loom production are only estimates based on the quantity of yarn available for consumption each year.

The table shows that foreign imports have been practically eliminated. We can also see that the hand-loom weaver's contribution to the total amount of cloth consumed in India is still very substantial, being more than one-third of the total consumption and more than one-half of the Indian mill production. Lastly, the table shows a downward movement of the *per capita* consumption due to war conditions and rise in prices.[4]

§5. **Some difficulties of the cotton mill industry.**—The position of the trade in piece-goods is in some ways more secure than that of the yarn trade. The weakness of the yarn trade lay in its excessive dependence on one market, viz. China, while the export of piece-goods commands a large number of markets, some of which are showing a steadily growing capacity for consuming Indian goods.

[1] *Review of the Trade of India* (1936-7), p. 43, and (1941-2), p. 110. These figures are inclusive of fents.

[2] Net imports = Imports of foreign goods minus re-exports of foreign goods.

[3] Net available mill production = Mill production in India minus exports of Indian piece-goods.

[4] Under the present (1950) system of rationing, the *per capita* supply of cloth is 12 yards a year and 18 yards per head per year is regarded as the maximum practicable in the course of the next few years.

The diminution in the off-take of a single customer is not, therefore, likely to affect the total volume of the trade to any considerable extent. It must, however, be admitted that Indian industrialists have not hitherto put forth any special efforts to develop foreign markets. The imports of piece-goods advanced considerably before 1930-1. Japan became a formidable rival as her goods, unlike those of Lancashire, competed directly with Indian manufactures. Japan's ability to undersell the Indian manufacturer was due to certain special facilities such as her superior climatic conditions which are conducive to greater efficiency of labour, the larger employment of cheap female labour which social conditions in Japan make possible, etc. Further, Japan's cotton purchases were on a large scale and highly organized both in the United States and in India (with the Chinese crop in reserve) which gave her a considerable advantage over India, though in regard to short-staple cotton the advantage, of course, is on India's side. The mixed Indian and American grey cotton cloth from Japan is more attractive than the Indian stuff. All these points can scarcely be called unfair advantages. But this situation was certainly one of the consequences of Japan's failure to ratify the labour Conventions of the Washington Conference in respect of hours of work, prohibition of employment of young persons and of women during night hours. Conditions of employment were inferior in Japan to those in India and they were obviously so till the Japanese Factory Law of 1926 came into operation in June 1929.[1]

The difficulties of the cotton industry have been enhanced by the frequent changes in the currency policy since 1893 and the enhancement of the ratio from 1*s.* 4*d.* to 1*s.* 6*d.* in 1924. The depreciation of the Japanese yen, e.g. in 1923-5 and again in 1932, intensified Japanese competition in Indian markets.

The depression in the cotton mill industry was also to some extent to be attributed to certain defects of organization such as over-capitalization; absence of technical experts on the boards of directors leading to expensive mistakes; improper handling of machinery which is also not replaced sufficiently often by new machinery; absence of up-to-date labour-saving devices; uneconomical handling of cotton, coal, waste and stores; absence of a systematic plan of short time when demand is slack, etc. We must also mention the defects of the selling agency system, and the absence of any satisfactory system of finance,[2] which seriously inconvenienced both mills and dealers.

§6. The managing agency system.—The managing agency system has come in for a good deal of damaging criticism and a few words about it may be permissible.[3] The managing agency is a private partnership of three or four members usually related to each other. The ownership of the agency was often (until 1936), governed by the hereditary principle, so that management often passed into

[1] For further figures and a survey of labour conditions, see M. C. Matheson, *Indian Industry*, Part II, ch. ii.

[2] 'Another common defect is that many mills depend for working capital mainly on short-term deposits, cash credits and loans, all of which are apt to be drastically curtailed in difficult times.'—Vera Anstey, *The Economic Development of India*, p. 275.

[3] For a brief and instructive account of the origin, uses and dangers of the managing agency system in India, see Anstey, op. cit., pp. 112-15, 253, and *Report of the Indian Tariff Board* (Cotton Textile Industry), 1932, pars. 65-83.

incompetent hands. The managing agents hold a large number of shares in the mill and make themselves responsible for the financing as well as management of the mill, the purchase of supplies and the sale of the goods. Some of the methods of remunerating the agents were apt to lead them into action which, while it added to their private gain, was prejudicial to the interests of the mill. For example, where their commission was based on the total volume of production, the interest of the agents lay in swelling the output as much as possible irrespective of the effect of such a policy on the profits of the mill. The managing agents have also been charged with taking secret commissions in the course of the buying and selling transactions which they undertake on behalf of the mill. Managing agents sometimes have no technical knowledge of their business and no technical expert on their staff and may consequently blunder into wrong decisions. Other disadvantages of the system are that it fosters indifference and ignorance on the part of the directors, who have no real responsibility. It also tends to make the shareholders powerless and irresponsible and therefore unwilling to make sacrifices for the company or invest more money in the business. It further favours excessive conservatism and lack of enterprise. Lastly, the fact that the economic development of India in the nineteenth and twentieth centuries has mainly been commercial rather than industrial is partly attributable to the managing agency system. It is quite true that if the managing agents had not taken upon themselves the responsibility for finance, in many cases providing finance themselves for industrial and commercial ventures, the economic development of India would have been even slower than it has been. Capital in India is notoriously shy, and the welcome change in the direction of greater readiness to subscribe on the part of the public is only a very recent phase. Even now no bank will make any advance unless the application is signed by the managing agents, who are held responsible in their personal capacity. Apart from the provision of the finances required for industries in respect both of fixed and working capital, the managing agency system is also associated with the pioneering of new industrial enterprises in the sense of prospecting, research, etc. It may also be admitted that during the unexampled depression of 1930-1 the managing agents readily bore their full share of the losses suffered by the industries, and not only surrendered any claim to their commission but provided much-needed funds. At the same time, it was generally recognized that the time had come for undertaking a radical reform of the managing agency system.[1] The Tariff Board in 1932 recom-

[1] 'It may be perfectly true that many, or even most, of the managing agents have performed their functions efficiently and with integrity, but this does not absolve from criticism a system which undoubtedly gives special opportunities for exploitation and even fraud. In any case it is generally recognized that the system is to a great extent responsible for the undoubted fact that industrial and commercial enterprise in India mainly rests with a comparatively small group of individuals, both Europeans and Indians. Consider, for instance, the position of the famous firm of Andrew Yule & Company, which acts as managing agents for a large number of industrial and commercial concerns, including at least ten jute mills, fifteen coal companies, two hydraulic companies, two oil mills, a flour mill, navigation, rubber, sugar, brick and pottery, and miscellaneous concerns of all descriptions (*Capital*, 3 March 1927). It is obvious that incidental earnings must be large and that it must at times be difficult to reconcile the various interests, and still more difficult for any one firm to control the destinies of such a vast and heterogeneous collection of businesses.'—Anstey, op. cit., pp. 501-2.

mended an early inquiry regarding legislative action so as to bring the managing agency system under better control. The Indian Companies Act, as amended in 1936, seeks to remove many of the managing agency evils by limiting the term of office of a managing agent to twenty years at a time, restricting transfer of his office and assignment of his remuneration by a managing agent, providing for his removal for fraud or breach of trust, prescribing a uniform basis (namely net annual profits) for the agent's remuneration, restricting the grant of loans to and purchase of debentures of one company by another under the same managing agent, etc.

§7. **Depression in Bombay.**—The depression was specially acute in the case of Bombay owing to circumstances already mentioned, namely the virtual loss of the China trade in yarn owing to Japanese competition and the expansion of the Chinese industry (a loss not wholly compensated by an increase in the export of piece-goods), difficulties of freight during and after the 1914-18 war, and the increase in the severity of internal competition from up-country mills especially from mills in the Indian States where labour regulations were lax and where there were often special duties against the products of mills in British India. No doubt this was partly the fault of the Bombay mills themselves because (i) they had neglected up-country markets in respect of diversification of production, especially in the higher counts, (ii) they had not maintained direct contact with the consuming centres, and (iii) their commission agents failed to show sufficient alertness. But Bombay also suffered from certain serious disabilities, for example its relatively higher cost of labour, fuel, water power, high local taxation (including the 10 per cent Property Tax levied in 1939 to pay for the cost of Prohibition), distance from the mofussil markets and from sources of raw material. That Bombay was losing the dominating place in the textile industry of the country is clearly seen from the fact that the number of mills working in Bombay declined from 78 in 1926 to 68 in 1939. During the same period the number of mills working in Ahmedabad increased from 59 to 77.

§8. **Protection to the textile industry.**—Since 1929 the question of protection to the cotton textile industry in India has been examined on three separate occasions by the Tariff Board, and also came into prominence in connexion with the Indo-British Trade Agreement (1939). The first survey was conducted in 1926, when it became evident that the industry was not in a satisfactory condition, particularly in Bombay. The Board reported in 1927 that the deterioration was mainly due to unhealthy internal conditions, to unfair and uneconomic competition from Japan and to the general trade depression.[1] To remedy the depression, which was particularly acute in Bombay, the Board suggested a better-organized purchase of raw materials, for example under a single hedge contract system; adoption of various devices to obtain a greater output from labour, such as the piece-work system, greater care in recruitment of labour, better housing and education for the labourer; more combined action furthering common interests on the part of millowners; greater diversification of production and more specialization in products of higher counts so as to take full advantage of the damp climate and the favourable situation of Bombay in respect of the imports of long-staple American and African cotton;

[1] *State Action in Respect of Industries*, 1928-35, p. 62.

development of new lines of production, for example the establishment of the cotton printing industry; more attention to the development of promising markets such as Iran and Iraq; maintenance of closer touch with consuming centres in India as well as abroad, etc.

As regards protection, the main recommendations of the Board were the raising of the import duty from 11 per cent to 15 per cent, bounty on the spinning of higher counts of yarn and the exemption from import duty of cotton textile machinery and mill stores. The Government of India proposed to accept only the last recommendation. Strong protests were made against this decision by the millowners, and, as a result, protective duties were imposed on cotton yarn to the extent of 5 per cent *ad valorem* or 1½ annas per pound, whichever was higher, by the Indian Tariff (Cotton Yarn Amendment) Act, 1927, for a period extending up to 31 March 1930. The duty on machinery and mill stores was also removed.

The existing import duty on artificial silk yarn was also reduced from 15 to 7½ per cent, so as to give some relief to the hand-loom industry from the burden imposed on it by the revised import duty on yarn, and to facilitate the diversification of Indian mill production. It may be noted that the hand-looms and cotton mills in India are using increasing quantities of such artificial silk yarn. The Government of India also appointed a Commercial Mission as suggested by the Board. All this, however, did not satisfy either the mill industry or public opinion in India. The depression in the industry continued and the general feeling was that more substantial help was needed.

§9. **Mr G. S. Hardy's inquiry (1929).**—As a result, the Government appointed Mr G. S. Hardy, Collector of Customs, Calcutta, in July 1929 to investigate the extent and severity of external competition.

Mr Hardy's Report[1] invited the Government to grant substantial assistance to the mill industry, and in April 1930 the Cotton Textile Industry Protection Act was passed which was mainly designed to afford sufficient protection against Japan until 31 March 1933. In consequence of this Act the general *ad valorem* duty was raised to 15 per cent. In addition to this, in order to enable Bombay to organize itself financially and technically, a minimum duty of 3½ annas per lb. was levied on the plain grey goods, which, in the words of Sir George Rainy, constitute 'the bread and butter part' of Bombay's business.

A special protective duty of 5 per cent was also imposed. The scope of this duty, however, was limited to non-British goods to limit the sacrifice which the consumer would be called upon to make without corresponding gain to the industry, which suffered more from Japanese than British competition. In spite of the Government's declaration that the preference to British goods was wholly accidental, the well-founded suspicion lingers that it was deliberate.

§10. **Further alterations in the duties (1931).**—Further protection was secured by the cotton mill industry, first, under the Indian Finance Act of March 1931, which placed an additional duty of 5 per cent *ad valorem* on imported cotton piece-goods, and secondly, under the Supplementary Finance Act of November 1931, which imposed a surcharge of 25 per cent on all import duties then existing, thus bringing the import duty to 25 per cent *ad valorem* or 4⅜ annas per lb., whichever

[1] See *Report on External Competition in Piece-goods* by G. S. Hardy, par. 11

was higher, in the case of plain grey goods of British manufacture, and 31¼ per cent *ad valorem* or 4⅜ annas per lb., whichever was higher, in the case of non-British plain grey goods. In the case of other goods the duty was 25 per cent on British goods and 31¼ per cent on non-British goods. The increased duty of 40 per cent on imports of artificial silk piece-goods was also expected to help the Indian cotton textile industry.

§11. **Second inquiry by the Tariff Board (1932).**—As the protective duties imposed by the Act of 1930 were due to expire on 31 March 1933, the Tariff Board was asked in April 1932 to inquire into the question of further protection to the cotton industry in India. Before the Board could complete its investigations, there was a serious fall in the Japanese yen and consequently in the rupee prices of cotton piece-goods imported from Japan. The Board was therefore directed to make an emergency inquiry (July 1932), as a result of which the import duty on non-British cotton piece-goods was raised from 31¼ to 50 per cent *ad valorem*, and the minimum specific duty on plain grey goods not of British manufacture from 4⅜ to 5¼ annas per lb. with effect from 30 August 1932. These rates were further increased to 75 per cent *ad valorem* and 6¾ annas per lb. respectively with effect from 7 June 1933, in order fully to counteract Japanese dumping. In the meantime the operation of the protective duties imposed in 1930 was extended up to 31 October 1933 to enable the Government of India to consider the Report of the Tariff Board on the textile industry. This period was again extended to 30 April 1934 pending the discussion of the question of the conclusion of a new commercial agreement between India and Japan in place of the old Indo-Japanese Convention of 1904, which was formally denounced by the Government of India in April 1933, since, under that Convention, they were not in a position to impose safeguarding duties on Japanese goods alone. At last the Indian Legislature passed the Indian Tariff (Textile Protection) Amendment Act, 1934, on 26 April 1934. The Act, which came into force on 1 May, gave effect to the conclusions of the Tariff Board recommending substantive protection to the cotton textile industry, modified in the light of a new Trade Agreement with Japan (1934) and of the unofficial agreement between the representatives of the Indian and the United Kingdom textile industries (known as the Mody-Lees Pact).[1] The Act fixed the rate of import duty on cotton piece-goods, not of British manufacture, at 50 per cent *ad valorem*, subject to a minimum of 5¼ annas per lb. in the case of plain greys.[2] The life of this Act was limited to 31 March 1939.

§12. **Special Textile Tariff Board (1935).**—A special Tariff Board was appointed by the Government of India on 10 September 1935 to investigate into and report on the question of protection to the Indian textile industry against imports from the United Kingdom.

The Board concluded its inquiry in December 1935 and its Report was released for publication in June 1936. Simultaneously, the Government of India announced, by a notification under Section 4 (i) of the Indian Tariff Act, immediate

[1] See ch. xiii.

[2] This was already the rate of import duty in force on non-British goods with effect from 8 January 1934, when the 75 per cent duty was reduced to 50 per cent as a result of the Indo-Japanese negotiations.

reduction (with effect from 25 June 1936) in the rates of duties on Lancashire piece-goods as recommended unanimously by the Tariff Board. The recommendations of the Tariff Board were:[1]

(i) That the duty on plain grey goods should be reduced from 25 per cent *ad valorem* or $4\frac{3}{8}$ annas per lb. whichever was higher, to 20 per cent *ad valorem* or $3\frac{1}{2}$ annas per lb. whichever was higher.

(ii) That the duty on bordered grey, bleached and coloured piece-goods (other than prints) should be reduced from 25 per cent *ad valorem* to 20 per cent *ad valorem*.

(iii) That the duty on cotton yarn should remain the same. Lancashire professed to be disappointed that the tariff reductions were not as substantial as the case merited. On the other hand, prominent Indian business men criticized the reduction of duties as being detrimental to the interests of the Indian mill industry which had only a limited scope for its natural expansion in the country.

§13. **Tariff changes under the Indo-British Trade Agreement** (1939).—The question of revising the duties on British piece-goods once again came into prominence in connexion with the protracted negotiations for the conclusion of a new trade agreement between India and the United Kingdom in place of the Ottawa Agreement.[2] Under the new Indo-British Trade Agreement signed on 20 March 1939, the exports of Indian raw cotton to the United Kingdom were to be linked up with the imports of British cotton piece-goods into India; and to this end the import duties on British piece-goods were to be further reduced. Accordingly, by the Indian Tariff (Third Amendment) Act enacted in April 1939, the protective import duties on British piece-goods were reduced to $17\frac{1}{2}$ per cent *ad valorem* on printed goods, 15 per cent *ad valorem* or 2 annas $7\frac{1}{2}$ pies per lb., whichever was higher, on grey goods and 15 per cent *ad valorem* on all others. These were the basic duties. The United Kingdom was granted a minimum import quota of 350 million yards, and the basic duties had to be reduced by $2\frac{1}{2}$ per cent if the imports of cotton piece-goods from the United Kingdom in any cotton piece-goods year fell below 350 million yards. The rates might be increased above the basic rates should the imports of British piece-goods to India exceed the maximum of 500 million yards. The enhanced duties were, however, to be reduced to the basic rates after the end of any year in which total imports from the United Kingdom had not exceeded 425 million yards. In determining the rates of duty to be charged on the United Kingdom piece-goods, regard was also to be paid to the exports of Indian cotton to the United Kingdom. The new agreement provided, on the one hand, for penalties in the event of a fall in the consumption of Indian cotton by the United Kingdom below a certain minimum (5 lakhs bales for the cotton year ending 31 December 1939, $5\frac{1}{2}$ lakhs for the year ending 31 December 1940 and 6 lakhs for any subsequent year) and, on the other hand, for rewards in the event of an increase in consumption above $7\frac{1}{2}$ lakhs of bales.

This new arrangement of a sliding scale of duties was strongly opposed by the

[1] *Report of the Special Tariff Board on the grant of protection to the Indian Cotton Textile Industry* (1936), pp. 109-14.

[2] See ch. xiii.

Legislative Assembly, and the Indian cotton textile industry, on the ground that it unduly favoured Lancashire without ensuring a corresponding gain to the Indian cotton grower, and sacrificed the interest of the Indian cotton mill industry by appreciably curtailing the protection granted to it at a time when the industry was doing none too well.

The Indian Tariff (Third Amendment) Act (1939), referred to above, also extended the period of operation of the protective duty on cotton piece-goods up to 31 March 1942.[1]

§14. **The cotton mill industry during the 1939-45 war and after.**—On the eve of the recent war, the cotton industry was in a stagnant condition owing to the reduction of home demand caused by the depression of 1929-33 and the recession of 1937-8. Other adverse factors were the re-entry of Japan into the Indian market, increased cost of production and heavy taxation in the form of the 10 per cent property tax in Bombay and Ahmedabad and the doubling of the import duty on raw cotton in 1939.

The second year of war, however, ushered in a period of steady improvement. Imports of piece-goods were negligible, especially after the freezing order against Japan in July 1941. There was an immense increase in war orders placed by the Government and the Eastern Group; and a big advance in the exports of cotton manufactures to South and West Africa, the Middle East, Australia, Malaya and the Dutch East Indies. The rise in the prices of cotton goods has been so heavy that the Government have felt compelled to take special steps for protecting the interests of the consumer. A scheme was put into operation for the production of cheap standard cloth for the masses by the mills in co-operation with the Government, who undertook to sell the cloth at fixed prices through their own agencies; but this was abandoned as the 'utility' cloth proved unsaleable and no appreciable increase of production resulted. In May 1946, an interim plan for the cotton industry was announced by the Government of India. The target of mill production within the next five years was fixed at 6,500 million yards per year. Hand-loom production was expected to contribute 1,500 million yards per year, raising the *per capita* consumption to 18 yards and leaving 800 million yards for export as a means of obtaining food-grains in exchange and maintaining potentially valuable contacts with overseas markets. A planned effort was to be made to bring about a more even distribution of the industry over the whole country.

§15. **The jute industry.**—The first jute-spinning mill was started at Rishra near Serampore in Bengal in 1855, and the first power-loom was introduced in 1859. The progress of the industry was slow during the first thirty years or so and there was scarcely any export trade in jute manufactures. During this initial stage of comparatively slow development, however, periods of great prosperity were enjoyed by the industry. From 1868 to 1873, the mills 'simply coined money', and paid dividends ranging from 15 to 25 per cent. This led to the establishment of a

[1] The import duties on British cloth were reduced with effect from 17 April 1940, in accordance with the Trade Pact with Great Britain. By the Indian Tariff (Amendment) Act, 1947, the existing protective duties were converted into revenue duties. On 1 January 1949 an excise duty of 25 per cent *ad valorem* was imposed on fine cloths and 3 pies per yard on medium and coarse cloth.

large number of new mills and to overproduction. Consequently, profits declined rapidly. The industry passed through a crisis and a number of mills had to be closed down. The jute industry, however, had reached large dimensions and in 1881 there were as many as 5,000 power-looms at work in Bengal. Since 1885 a tendency has been discernible towards a larger output of hessian cloth than gunny bags. Between 1877 and 1915, while sacking looms increased from 2,950 to 17,750 the hessian looms increased from 910 to 22,603, that is, there was a growth of 2,400 per cent in hessian looms as against 430 per cent in sacking looms. World War I led to a considerable expansion and prosperity of the jute industry, which was called upon to meet the demands in the various theatres of the war for sandbags for the trenches and jute canvas cloth for war purposes such as tent cloth, tarpaulins, wagon covers, etc. This new development was stimulated by the necessity of substituting jute for Russian flax, the supply of which was largely cut off by the overrunning of Russia by Germany in 1915-16. The recent war also imparted a stimulus to the jute mill industry owing to the large Government and overseas demand for sandbags and hessian cloth. (See §18 below.)

The story of the jute industry has been on the whole one of steady and continuous progress. In 1891 there were 8,000 power-looms at work in Bengal; in 1901, 16,000; in 1911, 33,000; in 1921, 43,000; in 1926-7, 51,061; and in 1937-8, 66,705. The table on page 32 further brings out the remarkable progress made by the industry. The effects of the world depression and of the recent war respectively on the jute industry are reviewed in later sections.

For many years Great Britain was the only country which manufactured jute goods, Dundee being the principal centre of manufacture. Calcutta has now taken a large part of the trade held by Dundee in the past. The value of jute manufactures exported by sea in 1928-9 was Rs. 56·9 crores, whereas the average value of the export in the period 1879-80 to 1883-4 was only Rs. 1·2 crores. Owing to trade depression the value of these exports declined to Rs. 21·38 crores in 1933-4. Since 1934-5, some improvement has been in evidence, the value of the exports of jute manufactures being Rs. 29·10 crores in 1937-8. It declined to Rs. 26·26 crores in 1938-9. Nearly two-thirds of the jute grown is normally consumed by the Bengal mills as compared with less than half before 1914, so that Bengal produces about twice as great a bulk of jute manufactured goods, mainly in the form of gunny bags, hessian cloth and cordage, as all the rest of the world.[1]

According to the latest available statistics (i. e. those for the year ended 31 December 1947) the total number of mills in the Indian Union is 113 and their aggregate loomage 68,547. The average number of workers employed in the mills is 300,000.

The partition has resulted in the jute industry (which is in the Indian Union) being cut off from the jute-growing areas (which are mainly in Pakistan). The Indian Union is the biggest consumer of raw jute while Pakistan is the biggest supplier. The partition has completely disorganized the jute industry especially since the devaluation of the rupee (September 1949). Pakistan has practically stopped exports of jute to India and India retorted (December 1949)

[1] See article on India, *Encyclopædia Britannica*, 14th ed.

by suspending exports of coal to Pakistan. There is now a movement in India towards self-sufficiency as regards supplies of raw jute.

	Number of mills at work	Authorized capital in lakhs of rupees	Number in thousands		
			Persons employed	Looms	Spindles
Average					
1879-80 to 1883-4 ..	21	270·7	38·8	5·5	88
1899-1900 to 1903-4 ..	36	680	114·2	16·2	334·6
1909-10 to 1913-14 ..	60	1,209	208·4	33·5	691·8
1914-15 to 1918-19 ..	73	1,403·6	259·3	39·7	821·2
1925-6	90	2,134·7	331·3	50·5	1,063·7
1928-9	95	2,336·7	343·9	52	1,108·1
1930-1	100	2,360·6	307·6	61·8	1,224·9
1933-4	99	2,370·6	257·1	59·5	1,194·4
1937-8	105	2,488·5	308·7(*a*)	52·4	1,108·1

(*a*) According to *Large Industrial Establishments in India* (1937).

The demand for jute goods depends on the volume of agricultural production throughout the world, jute manufactures being required for moving agricultural produce from one place to another in the course of internal as well as international commerce. A favourable agricultural season in India leads to a shrinkage of exports of jute manufactures as the demand for packing material increases within the country itself for moving the large volume of crops. So also a fall in external demand as in years of economic depression adversely affects exports of jute manufactures. The search for a substitute for jute has not so far met with any marked success, and indeed new uses have been found for jute. The U.S.A. and other countries are, however, to some extent resorting to cotton in place of jute bags. Such a possibility has now arisen in India itself. The Indian Central Jute Committee, established in 1936, has undertaken research work in jute and jute products with a view to preventing any possible loss of markets.

§16. Jute and cotton industries compared.—The jute and cotton manufactures are outstanding examples of the progress of modern large-scale industry in India. The position of the jute industry in international trade is much stronger than that of the cotton industry, jute being an Indian monopoly. As already pointed out, one remarkable contrast between these two most important organized industries of India is that, while the cotton mill industry is almost entirely in Indian hands and financed by capital raised in India, the jute industry owes its origin and development to European—mostly Scottish—enterprise and capital. Another point of difference is that while the cotton industry is decentralized, the jute industry is highly centralized, there being as many as ninety jute mills within a radius of forty miles. Lastly an average jute mill is a far bigger unit than an average cotton mill.

As Dr Pillai observes, 'in point of efficient organization, the jute industry is perhaps second to none in India'.[1] This has been made possible by its highly centralized position. The Indian Jute Mills Association was formed in 1886, to faci-

[1] P. P. Pillai, *Economic Conditions in India*, p. 175.

litate, among other things, the adoption of concerted action as regards introduction of short-time working in the mills to avoid overproduction, etc. The high profits reaped during the war of 1914-18 led to overproduction, and after the war was over the industry had to pass through bad times. While the demand slackened, the costs of production increased, owing to a rise in the price of jute and in wages.[1] In 1921-2 the Association invited an American business expert to advise it on the possibility of forming a jute trust with a view to exercising some control over the production and price of jute. The termination of the slump, however, led to the abandonment of the project for the time being. The Calcutta Jute Dealers' Association looks after the common interests of its members as dealers in jute for local consumption.

§17. **The jute industry during the depression and after.**—The jute mill industry by no means escaped from the effects of the last world economic depression, which affected almost every industry to a greater or less extent. The jute industry suffered from declining prices, presence of heavy stocks at the principal consuming centres, frequent labour troubles, etc. But on the whole it faced the difficulties of the post-war (1929) depression much better than the Bombay cotton mill industry. It was thus rewarded for its care in maintaining adequate reserves and its systematic adoption of short time when necessary. During the ten years ended in March 1936, a policy of curtailment of output was continuously in force. The mills in the membership of the Association worked forty hours a week and with a certain percentage, varying from fifteen in 1931 to ten in 1935, of looms sealed. The lowering of the percentage of the looms sealed was caused by the competition of the mills which were not parties to the Restriction Scheme and by the improved outlook in trading conditions and the competition from other manufacturing centres. Agreement could not be reached with the non-Association mills. Mills in the membership of the Association were therefore given liberty to work without any restriction either on the hours of work or machinery. The year 1937 was critical for the jute manufacturing industry, owing to unrestricted production and labour trouble. The following year saw a worsening of the position due, among other factors, to the effects of 'recession' in business conditions and the growing internal unrestricted competition. By September 1938, the jute industry appeared to be heading towards a major crisis, and in the interests of the well-being of Bengal, the Provincial Government had to step in and by an Ordinance issued in September 1938 assumed control over the industry and limited the hours of work to 45 per week.

The conclusion of a new voluntary short-time working agreement between the Association and the outside mills in January 1939, accelerated by fear of the Government Ordinance being converted into permanent legislation, obviated the need for restricting the working hours by law. By a supplementary agreement in July the mills agreed to work 45 hours per week with 20 per cent of the hessian and 7½ per cent of the sacking looms sealed. The fall in the price of raw jute and its adverse effects on the jute-grower in Bengal led to the promulgation of two Ordinances by the Provincial Government for fixing the minimum prices of raw jute and hessian in August 1939.

[1] For a survey of the jute industry see Matheson, op. cit., Pt. II, ch. iv.

§18. **Effects of World War II on the jute mill industry.**—The outbreak of World War II brought a feverish overseas demand for all sorts of jute goods and lifted the jute industry out of acute depression. The monthly production rose sharply from 90,700 tons in September 1939 to 125,700 tons in March 1940. Shipments of jute manufactures established a fresh record for the decade and totalled 1,098,725 tons out of 1,280,400 tons produced during the year. There was a remarkable increase, largely speculative in character, in the prices of both jute and jute manufactures. Restrictions on working hours were withdrawn and the mills went into full production at sixty hours per week, the Government of India having suspended certain provisions of the Factories Act by an Ordinance. The Government of Bengal also postponed consideration of a Bill for restricting the area under jute cultivation.[1]

The position of the jute industry is not, however, entirely healthy. The speculative rise in jute prices has already had adverse reactions on the industry. There are indications that the demand has been checked by high prices, and the adoption of substitutes is being encouraged. The periodical slackening of war orders and the loss of the continental markets of Europe also had a depressing effect. The Jute Mills Association decided in August 1940 to curtail the working hours to 45 per week and to work for only three weeks in the month. With new orders for sand-bags, the working hours were again increased to 60 but reduced to 54 from 18 May 1942, when 10 per cent of the looms were also sealed. During the recent war about twenty-six mill units were requisitioned to provide accommodation for military stores and equipment. But although the industry was thus deprived of 25 per cent of its productive capacity, it was able to meet all demands, including the war demands. The problem of the industry is one of excess capacity which explains its policy of restrictionism involving curtailment of hours of work and output and distribution of profits to mills for abstaining from working. Although efficient as compared to most other Indian industries, the Indian jute industry compares unfavourably with its foreign counterparts in Scotland, France and elsewhere in point of productive efficiency. In order to maintain prosperity it must tackle, with vision and determination, the problem of reorganization and improve its methods of production and marketing and enlarge the variety of its products to suit the diversity of demand. The partition, since it involved the splitting up of the jute industry and the jute-growing areas, has added to the difficulties of the industry in maintaining supplies of raw material. The future of the industry will depend hereafter on the maintenance of friendly relations between the two Dominions.

§19. **Iron and steel industry.**—The iron and steel industry has a better claim than almost any other to be called a basic or 'key' industry, and its national importance cannot be exaggerated. A striking contrast between the industrial revolution of India and of England is that, while the revolution began in India with the application of steam to the textile industries, it began in England with the development

[1] Subsequently, however, the Bengal Legislature passed the Bengal Jute Regulation Bill in August 1940 which was applied to the crop to be grown in 1941, in the interest of the growers. Earlier, in May 1940, the Government of Bengal issued two Ordinances for fixing the minimum and the maximum prices of raw jute and hessian in the futures markets.

of the essential iron and steel industries. The new industrial system in England had a solid foundation in the firm establishment of the iron and steel industry and the ancillary mechanical engineering industries. But such a development has not marked the course of the revolution in India. Until recently Indian industries have relied almost exclusively upon imported machinery, machine tools, and hardware goods in general.

Pioneer attempts to introduce modern methods for the manufacture of pig-iron and steel were made as early as 1830 in the South Arcot district. They were all destined to failure until the Barakar Iron Works, which were acquired in 1889 by the Bengal Steel and Iron Company, were started in 1874 in Bengal on the Jherria coal-fields. The Bengal Steel and Iron Company began to show a profit only from 1899. The annual production at the beginning of the present century was about 35,000 tons. An attempt to make steel resulted in heavy loss.[1] A new era in the history of the Bengal Company, however, began in 1910 with the exploitation of a new source of iron ore in the Singhbhum and Manbhum districts.

The next important stage in the history of the industry was ushered in by the formation of the Tata company. The company was established at Sakchi in the Singhbhum district by the late J. N. Tata in 1907, and the construction of the works began in 1908. Pig-iron was first produced in December 1911, and steel—for the first time in India in modern times—in 1913; and by 1916, under the stimulus of the war demand, the whole plant was in full production. Thus after a somewhat anxious period, the works were placed on a sound footing and proved of invaluable assistance in the war in providing large quantities of rails and sleepers for military railways in Mesopotamia, Palestine, East Africa and Salonika. In 1917 a large scheme of extension was mooted and completed in 1924. The old plant turned out finished steel products, such as rails, heavy structurals (beams, angles, channels), bars, light structurals, light rails and fish-plates. The additional products which the new plant has been turning out since 1926 are plates, sheets (black and galvanized), sheet bars and sheet sleepers.[2] The success of the Tata enterprise has called into existence some new companies, such as the Indian Iron and Steel Company formed in 1908 by Messrs Burn & Co. of Calcutta, at Hirapur near Asansol, the Mysore State Iron Works started at Bhadravati in 1923, etc. It may be noted that at the last named works blast furnaces are fired by charcoal.

The steady expansion of the industry under the stimulus of protection is reflected in the figures of production and imports. The production of pig-iron advanced from 35,000 tons at the beginning of the century to 1,576,000 tons in 1938-9, of which 514,000 tons valued at Rs. 256 lakhs was exported, Japan being the principal customer. Next to Japan, the United Kingdom and the U.S.A. have been substantial buyers of Indian pig-iron. The quality of the pig-iron turned out is fully equal to that of the continental product; indeed the imports of pig-iron are now almost negligible. The production of steel advanced from 139,433 tons in 1916-17 to 599,565 tons in 1927-8 and that of finished steel from 98,726 to

[1] *Industrial Handbook of the Munitions Board*, pp. 138-9.

[2] *Report of the Tariff Board on the Steel Industry* (1924), pars. 14-15.

428,654 tons during the same period. The production of steel ingots was 977,000 tons and that of finished steel 726,000 tons during 1938-9. The world-wide campaign of rearmament gave an impetus to the steel and iron industry and India took advantage of the world situation to consolidate her own industry.

§20. **The iron and steel industry today.**—The outbreak of war in September 1939 gave a fresh stimulus to the iron and steel industry of India. The mills received large orders from the Government and Railways and have consequently enjoyed a period of boom, which is reflected in high dividends on steel shares and a sharp rise in their prices. The rapid expansion of Government ordnance factories in India also accelerated the expansion of the Indian steel and engineering industries. This is indicated by the figures during the year 1939, when the outpu of pig-iron totalled 1,835,000 tons compared with 1,575,000 tons in 1938. The manufacture of steel ingots and finished steel increased to 1,067,000 tons and 1,062,900 tons respectively, showing a gain of 9·2 per cent and 14·1 per cent respectively over the previous year. Production in 1939 was almost double that in 1932-3.

Owing to the war, imports of protected iron and steel in the year 1939 were the lowest in the history of the industry. On the other hand, Indian exports of iron and steel excluding pig-iron and iron ore were up during the year by 25 per cent, and the prices realized were high.

New steel plants have been installed at Jamshedpur for rolling billets and the manufacture of wheels, tyres and axles, thereby opening the possibility of large-scale manufacture of locomotives and wagons in the country.

§21. **Imports of iron and steel.**—India is still dependent to a large extent upon foreign iron and steel in spite of her own increasing production. The pre-1914 average of India's imports of iron and steel was 808,000 tons valued at Rs. 12·48 crores. During the 1914-18 war years the average imports declined to 422,000 tons valued at Rs. 10·11 crores. It was during this period that the Tata company increased its output and supplied the Government with war materials. During the inter-war years the imports steadily increased from the average of five years of 661,000 tons valued at Rs. 21·38 crores to 968,000 tons in 1929-30 valued at Rs. 17·16 crores. These increased imports in spite of increasing home production were attributed to increasing consumption in India by railways and other public works, as also by the building trade. This inter-war increase in imports furnished an added plea for protection being granted to the industry. The world economic depression and the increase in home production have led to a decline of imports in recent years, and the decline was emphasized in the course of the recent war.

§22. **Subsidiary industries.**—Before turning to the question of protection let us refer to some striking developments in connexion with the establishment of subsidiary industries, in the neighbourhood of Jamshedpur (formerly Sakchi). The following are some of the various manufactures which are produced under the Extension Scheme:—steel tubes, tinplate, enamel ware, wire, nails, railway wagons cast-iron sleepers, tea and jute mill machinery, agricultural tools, galvanized products, iron and steel castings, heavy chemicals, sulphuric acid, nitric acid, fertilizers, lime, ammonium sulphate, etc. There are hundreds of workshops all over the country getting their materials from the steel industry. Various manufacturing

companies have already been established for this purpose. Jamshedpur and the surrounding territory are thus developing into a veritable beehive of modern industries.

§23. **Grant of protection to the iron and steel industry.**—The policy of discriminate protection was brought into operation for the first time in India in the case of the iron and steel industry, as recommended by the Fiscal Commission. The Tariff Board constituted in July 1923 came to the conclusion that the industry satisfied all the conditions laid down by the Fiscal Commission except as regards labour, as 'India suffers under a disadvantage inevitable in any country mainly agricultural, and where industrial experience and training has still to be acquired', rendering it necessary to import at present skilled supervisors from America and Europe. This was, however, a temporary handicap which would eventually disappear. The Board held that unless protection was given, there was no hope of the industry developing for many years to come, and there was a serious danger that it might cease altogether. It also agreed that it was a basic industry and one that was essential for military purposes, and was, therefore, specially entitled to protection. The burden on the consumer was expected to be temporary and widely diffused.

The Steel Protection Bill incorporating the recommendations of the Board was passed in June 1924. The duties on certain articles manufactured from steel were increased, and bounties (amounting in all to about Rs. 242 lakhs during 1924-7) were granted on heavy steel rails, fish-plates and railway wagons manufactured in India. At the end of the period, the bounties and duties alike were to be subject to revision.

Subsidiary measures of protection had to be taken to safeguard the interests of such of the industries as make use of steel as their raw material. An increase in its price due to protection was likely to be detrimental to many branches of the engineering industry at a time when it was holding its own with difficulty in the face of foreign competition. The Tariff Board made certain recommendations to meet this aspect of protection to steel, which were accepted by the Government and the Assembly. The engineering industry was protected by higher duties on imported fabricated steel with certain exceptions.

§24. **Statutory inquiry into the steel industry (1926-7).**—As provided for by the Steel Protection Act, 1924, which was due to expire on 31 March 1927, the Tariff Board carefully examined the position of the industry in 1926 and recommended the continuance of protection on certain lines for a further period of seven years. The industry was now to receive protection in the form of increased duties on import and not by bounties on production, since the latter would be too costly to maintain over a period of seven years, at the end of which a fresh inquiry was to be made in order to ascertain what kind and amount of protection might still be necessary. Accordingly, a Bill was introduced in the 1927 Delhi Session and came into force on 1 April 1927. It provided for an imposition of different rates on certain iron and steel articles, with a basic duty on articles of British manufacture and an additional duty on those of non-British origin. There was a heated debate in the Assembly on the proposal to differentiate between standard and non-standard steel, which was practically between British and continental steel. The Government held

that this was necessary in order to secure a fair distribution of the burden on the different classes of consumers and to ensure stability to the scheme of protection. The opposition suspected that the Bill contained the principle of preference to British steel, to which they were opposed.

§25. **Further measures of protection to the iron and steel industry.**—The Indian Tariff (Ottawa Trade Agreement) Amendment Act, 1932, which came into force from 1 January 1933, gave effect to the tariff changes necessitated by the trade agreement made by the Government of India and His Majesty's Government in the United Kingdom at the Ottawa Conference held during July and August 1932 and the supplementary agreement regarding iron and steel in the September following. In the class of iron and steel goods, the preference extended only to those commodities not subject to the protective duties. The supplementary agreement provided for the adjustment of the Indian import duty on galvanized sheets as follows: Rs. 30 per ton on sheet made in the United Kingdom from Indian sheet bar; Rs. 53 per ton on sheet made in the United Kingdom from other sheet bar; Rs. 83 per ton on sheet not made in the United Kingdom. The period of operation of the protective duties imposed by the Act of 1927 was extended up to 31 October 1934. Meanwhile, in accordance with the Steel Industry (Protection) Act, 1927, the whole question of the renewal of protection was reviewed by the Tariff Board. The Iron and Steel Duties Act, 1934, gave effect on and from 1 November 1934 to the protective measures recommended by the Board. As the recommendations of the Board involved considerable reduction in the level of import duties in certain important cases with a resultant reduction in the revenue derived from customs, it was found necessary to impose as a revenue measure an excise duty of Rs. 4 per ton on the production of steel ingots in British India, and to impose a countervailing customs duty on steel ingots. This countervailing duty is additional to the protective duties recommended by the Board and alternative to the *ad valorem* revenue duties on articles in respect of which protection had not been proposed. As recommended by the Tariff Board the supplementary agreement was terminated in 1934.[1]

On the whole, Government policy after 1924 was helpful to the steel and iron industry. Without the timely intervention of the State the industry could not have survived the shock of post-war competition. However the protection afforded between 1924 and 1927 was not quite adequate and the Tata Steel Company was barely able to pay its way. In spite of certain unfavourable circumstances, however, the industry made appreciable progress 'as evidenced by increase of output, improvement in the efficiency of labour, reduction in the number of foreign hands, and considerable reduction in works costs' and also by 'considerable improvement in the conditions of labour, especially in respect of wages, housing and various amenities of life'.[2] The reduction in the cost of production has stabilized and improved the condition of the industry and as a result imports have been diminishing. The recent war brought into existence a number of factors favourable to the industry, such as the practical cessation of imports, the growth of civil and military demand, and the increase of exports. In fact the demand was so great that the indus-

[1] B. N. Adarkar, *History of Indian Tariffs*, p. 22.

[2] See H. L. Dey's article, 'Protection of the Steel Industry, 1924-7', in *Indian Journal of Economics*, July 1928.

try found great difficulty in meeting it. The Government were therefore forced to introduce a scheme of rationing in order to secure a balanced distribution of steel for military and civil purposes. Besides greatly increasing the volume of production in old lines, the industry has branched out into a number of new directions. For example, recent developments at the Tata Steel Works have increased the possibility of making railway locomotives in India.

Closely connected with the war-time development of the iron and steel industry is the progress made by the engineering industry, of which the following are the most important aspects:

(i) *Ordnance Factories*. Government Ordnance Factories have been greatly expanded and modernized under the Defence Department Scheme as approved by the Chatfield Committee. With the increased production of guns, shells and high explosives, India became the arsenal of the East and the Middle East.

(ii) *Machine Tools*. During the war some progress was made in the manufacture of machine tools of various kinds ranging from simple drills and lathes to special-purpose machines required for munition production. Very little however has been achieved in the manufacture of heavy machinery needed for mills, ships, automobiles, aeroplanes, etc.

(iii) *Engineering Stores*. The war gave a big stimulus to the manufacture of engineering materials and stores, such as steel pipes, sheds, cranes, petrol-storage and water-storage tanks, stirrup pumps, lorries, armoured cars, wagons, railway stores, electrical stores, steel wire ropes, fire-fighting appliances, etc.

Before 1914, India was almost entirely dependent on imports for iron and steel products. This dependence has now largely vanished. It must however be noted that our consumption of iron and steel is at present below the pre-1914 level. Production will therefore need to be increased rapidly and substantially, especially in view of the era of intensive industrialization and reconstruction on which the country is about to embark and in view of the necessarily increased needs for defence purposes of an independent India.

§26. **Tanning and leather industry.**[1]—India possesses a large supply of hides and skins. The cow-hides, 'East India kips' as they are called, goatskins, buffalo-hides and sheepskins, etc., may be regarded as the by-products of her agricultural industry. Previous to the war of 1914-18, India made large exports of raw hides, especially to Germany and Australia, which were valued at Rs. 7·17 crores in 1913. In the same year, raw skins valued at Rs. 3·4 crores were exported, mainly to the U.S.A. There was a large demand in foreign countries and high prices were offered.

There has long existed a considerable indigenous tanning industry under which locally available tanning materials are used for curing and tanning hides mainly to meet the local demand for inferior kinds of leather. But the most striking changes have taken place in the European methods of tanning which were

[1] The Hides Cess Inquiry Committee estimate the value to India of this industry taken as a whole (that is the raw stock and leather trades and the leather, leather-working and allied industries) at about Rs. 40 to Rs. 50 crores. It provides employment to large numbers of men and is a factor in the economic well-being of millions of India's depressed classes.—*Report of the Hides Cess Inquiry Committee* (1930), par. 158.

first introduced by the military authorities to manufacture superior leather suitable for harness and other military requirements; and tanneries usually followed the establishment of arsenals. At Cawnpore, a further step in production was taken in 1860 when the Government Harness and Saddlery Factory was set up. Shortly afterwards, Messrs Allen and Cooper established the Army Boot and Equipment Factory and received at the outset considerable financial assistance from the Government. The Western India Army and Equipment Factory was started at Sion in Bombay by Adamjee Peerbhoy. A few more factories were established at various centres where the production of finished goods was attempted. Although considerable use of machinery is made in European tanneries and leather-working factories, it was until recently conspicuous by its absence in the Indian tanneries, except in the Cawnpore and Sion factories and the Madras Tannery, which produced the whole of the half-tanned leather and skins that loom largely in the export trade of the country. Before 1914, the bulk of the export trade in tanned hides and skins was confined to the south of India where the bark of *Cassia auriculata*, known in Madras as *avaram* and in Bombay as *tarwar*, is obtainable, Madras having by far the larger number of tanneries.[1]

The tanning and leather industry underwent a remarkable transformation during the war of 1914-18. The Indian Munitions Board directed its activities towards increasing the outturn and regulating the production of those kinds of leather which possess a special value as war material. The most important development was connected with the great increase in the production of East India tanned kips, from the Madras and Bombay tanneries. The value of these kips for making the 'uppers' of army boots was realized during the war and the Government assumed complete control of the trade, purchasing in India the whole of the available supply for export direct to the British War Office. Whereas 194,763 cwt of tanned hides valued at Rs. 1·75 crores was exported in 1913, in 1917-18, 361,674 cwt valued at Rs. 4·86 crores was exported. In addition to the export trade in East India kips, Indian tanneries produced during the war period greatly increased quantities of leather accoutrements of all sorts and boots for the army in India and the Indian Expeditionary Forces. Thus, under the direction of the Munitions Board, the Government gave a great stimulus to the tanning industry, and the annual output of manufactured boots and shoes was twenty times bigger at the end of the war than before it.

The industry was further expanded to meet the increased demand during the recent war. Extended machinery and a large labour force were employed in fulfilling war supply orders. The entire output of the organized tanneries of the country was taken over by the Government in January 1942.

The chrome process of tanning, which enables superior leather to be produced, has made very slow progress in India. The Government of Madras did valuable pioneering work from 1903 to 1911 to demonstrate that chrome tanning could be successfully established in this country. It is, however, to be regretted that the Government had to sell the factory in response to protests from the Upper India and Madras Chambers of Commerce, who raised the cry that private trade was

[1] Matheson, op. cit., Pt. II, ch. v, pp. 64-5.

invaded. After 1914, however, progress was more rapid; and Indian chrome leather hides found a profitable market in Great Britain. There are several difficulties experienced in connexion with the development of chrome tanning in India, such as the highly technical processes requiring chemical knowledge and costly mechanical equipment. A considerable proportion of Indian cow-hides and goatskins is, however, eminently suited to this class of work, and promising developments are expected. The Industrial Research Bureau undertook in 1939 an industrial survey of the Indian tanning industry with a view to effecting a general improvement in the standard of tanning technique and thereby developing an export trade of finished leather of good quality.

§27. **Protection to the tanning industry.**—In 1919, the Indian Tariff Act of 1894 was amended and an export duty of 15 per cent on hides and skins was levied with a rebate of 10 per cent on hides and skins exported to other parts of the Empire and actually tanned there. The duty was imposed as a measure of protection but as the Indian tanneries could only deal with a small proportion of the total supply of hides and skins in the country, the rebate was defended as a measure of help to the tanning industry within the Empire, so as to divert the tanning of Indian hides from Germany to the British Empire. The experiment, however, failed to achieve either of the objects. The Fiscal Commission condemned the duty as wrong in principle, on the ground that if protection was needed, it should have been given through an import and not an export duty. The Government of India reduced the rate to 5 per cent and abolished the 10 per cent rebate in 1923, the retention of the 5 per cent duty being justified on the ground of revenue need. The majority of the Taxation Inquiry Committee, agreeing with the Fiscal Commission, advised its early abolition, but recommended the retention of the duty on skins which enjoyed a good reputation in the world market and were not injuriously affected by the duty.

The 5 per cent export duty on raw hides was abolished by the Finance Act of 1934 owing to the decline in the export trade in raw hides with Germany, while the export duty on raw skins was abolished by the Finance Act of 1935 in order generally to help the revival of the export trade of India (see also ch. xii).

The claims for protection of the Indian tanning and leather manufacturing industry as a key industry deserve to be carefully considered. Alongside of protection, however, there is considerable scope yet for internal improvement, for the principal difficulty which the industry has to face is the lack of organization and expert skill.

§28. **Chemical industries.**—'In a modern State the development of chemical industries on a scale that renders them an important factor in the economic life of the State—as they are in England, Germany and America—necessitates the provision of certain essentials at sufficiently low rates.' These essentials are, at first, the fundamental heavy chemicals, especially sulphuric and hydrochloric acids, lime, caustic soda, sodium carbonate, nitric acid, etc. They are used in the production of other chemicals from indigenous sources, and also for refining the various natural products or materials derived from such products. Thus large quantities of sulphuric acid and alkali are required for refining fixed and mineral oils. The

other two essentials are (i) fuel for power, heating purposes and metallurgical operations; and (ii) chemical plant.[1]

Though the war of 1914-18 gave a considerable stimulus to many of the chemical industries, India still depends largely upon foreign chemicals. Thus in 1938-9 she imported chemicals of the value of Rs. 305 lakhs, as compared with the pre-1914 average of Rs. 90 lakhs. The production of chemicals in India, though gradually on the increase, is not sufficient to meet her own requirements. Chemicals derived from sulphuric acid have been manufactured, but no serious attempt has so far been made at the manufacture of alkalis, which do not enjoy the advantage of natural protection possessed by acids on account of the heavy cost of their transport by sea. An interesting recent development is the flotation of two companies—one by the Imperial Chemical Industries and the other under the management of Messrs Tata & Sons—for the manufacture of soda ash, caustic soda and eventually of other allied chemicals.[2] On account of heavy imports of soda ash and caustic soda permitted by the Government during the fiscal year 1948-9, the indigenous industry has suffered a serious set-back.

India's sources of raw materials for heavy chemicals are not deficient if only the various mineral ores were to be properly treated. Her varied mineral wealth in sulphide ores, saltpetre, alum salts, limestone, magnesium, etc. has already been indicated. Striking success has already been achieved in the manufacture of sulphuric acid which is a most important material for all chemical industries, so much so that its production is suggested as a test for judging the wealth of a country. There was a large demand for it, especially between 1914 and 1918, for explosives, and the industry is already established. The Eastern Chemical Co. Ltd., Bombay, put up a case in 1928 before the Tariff Board for a substantial subsidy for the manufacture of sulphuric acid. Before the 1939-45 war the industry had to face the keen competition of powerful European syndicates, Germany and the United Kingdom being the most serious rivals.[3]

The other essentials of chemical industries are fuel and plant. The fuel situation has already been examined and it has been shown how Indian coal deposits are unevenly distributed. Attempts are necessary to supply cheap electric power for the development of electro-metallurgical and electro-chemical industries. The special plant required by the chemical industries was imported before 1914, but much of the simpler plant can be locally manufactured and a start has already been made in this direction.

§29. **Effects of the recent war on the chemical industries.**—World War II gave a fresh stimulus to the chemical industry and has brought into prominence the question of replacing imports which have been appreciably curtailed. Chemical and pharmaceutical manufacturers, who met in conference at Calcutta in November 1939, are exploring the possibilities of developing the manufacture of new lines of chemicals in India. The Government of India have recently sanctioned the erection of a Government plant for the manufacture of heavy chemicals. A large variety of drugs previously imported are now being made in this country. Aviation spirit is

[1] *Industrial Handbook*, p. 58.
[2] *Review of the Trade of India in* 1938-9, p. 105.
[3] See *Report of the Tariff Board on the Heavy Chemical Industry* (1929), par. 72.

being manufactured from Indian crude oils, while the manufacture of bichromite is well in hand. The production of sulphuric acid and sulphate of ammonia has risen by 15 per cent. While the Government have taken steps to produce bleaching powder, the Scientific and Industrial Research Board is also considering the possibility of manufacturing dyestuffs, vegetable and synthetic, out of indigenous materials.

§30. **Protection to the heavy chemical industry.**—The heavy chemical industry is a key industry whose products are used in almost all industries. It is indispensable for national defence and it provides an essential foundation for chemical research in industries and agriculture. At the expiration of a period of seven years of protection, a fresh inquiry was to be held as in the case of the steel industry. A bounty was to be granted for the manufacture of superphosphate which is used as an artificial fertilizer. The Board recommended reduction of railway freights with a view to the formation of a large-scale chemical industry in India.[1] After a considerable delay the Heavy Chemical Industry (Protection) Act, 1931, gave effect to some of the recommendations of the Tariff Board. It removed magnesium chloride from the free list and imposed on this and certain other heavy chemicals protective duties at various rates. These duties were to remain in force till 31 March 1933 except in the case of magnesium chloride which was to remain protected up to 31 March 1939 and the duty on which could be enhanced if necessary. The other duties imposed by the Act lapsed on 31 March 1933 and the question of continuing protection was referred to the Tariff Board in December 1937. The Board recommended its continuance to safeguard the industry against foreign competition, especially dumping from Japan.[2] Protection at a reduced rate, namely twelve annas instead of fifteen annas per cwt recommended by the Board, was provided for by the Indian Tariff Amendment Act (1939) enacted in April 1939.

§31. **Oil-milling industry.**—Though India produces a variety of oil-seeds, she is mainly a seed-exporting country and has not properly developed the manufacture of finished products such as refined oils and oil-seed cakes. In Europe and America, efficient plant and improved processes are used. In India we still do our oil-pressing mostly by the archaic method of the bullock and the *ghani*, which leaves a large percentage of oil in the cakes, impairing their usefulness for cattle feeding or as fertilizers. In addition to this the oil is usually highly coloured and impure and fetches comparatively low prices in the market.

There has been in recent years a great increase in the number of oil-mills worked by steam or other mechanical power, especially in the case of mustard oil, castor oil, and groundnut oil. It is both unsound and uneconomic for India to export her oil-seeds instead of manufacturing the oils and oil-cakes herself. She is thereby deprived of the manufacturer's profits, and Indian agriculture of cattle food and manure of high value. Moreover, vegetable oils have several important uses and play a great part in the economic life of a civilized community. Vegetable oils and tallow are necessary for the manufacture of soap, glycerine, and for culinary and lubricating purposes. Since the 1914-18 war considerable attention has been given to the

[1] See *Report of the Tariff Board on the Heavy Chemical Industry* (1929), par. 74.
[2] *Report of the Tariff Board on the Magnesium Chloride Industry* (1938), p. 15.

possibility of developing the Indian oil-milling industry on a large scale. World War II gave it a fresh stimulus, and the need for further development has become all the more urgent owing to decline in exports.

§32. **Paper-making.**—The production of machine-made paper in India in modern times apparently dates from 1870 when the Bally Mills were established on the Hooghly. Its neighbourhood is still the principal centre of the industry. The Titaghur Paper Mills were established in 1882 and absorbed in 1903 the Imperial Paper Mill, which had been started at Kankinara in 1892-4. For thirty years after 1892 no new paper mill was established on the Hooghly, but in 1922, the Indian Paper Pulp Company, which was formed in 1918 for the production of pulp and paper from bamboo, commenced manufacture of paper in the Naihati Mill. As regards the up-country paper mills the oldest of them, the Upper India Couper Mill, was established at Lucknow in 1879. In 1885, the Deccan Paper Mill Company was formed and started work at Poona in 1887. The most important up-country paper mill at present is at Raniganj. It was started in 1891 by the Bengal Paper Mill Company formed in 1889. The Punjab Paper Mills Company has obtained a large concession with regard to *bhabar* grass in the Punjab for its factory near Saharanpur. In Assam, a new company has been formed and at Chittagong a new factory for manufacturing paper pulp from bamboos has been opened. In 1938-9 there were altogether eleven paper mills in India, namely four each in Bengal and Bombay, and one each in the United Provinces, Madras and Travancore. Several new concerns have since been floated for the manufacture of paper in India, notably the Mysore Paper Mills which started operations at Bhadravati in 1939, and the Sirpur Paper Mills in the Nizam's Dominions (1942). The recent war has benefited the paper industry as is shown by the increase in production, which in the year 1944 amounted to 103,884 tons as against 48,531 tons in 1938.[1] The prices of paper have also gone up by more than 300 per cent.

The Tariff Board estimated the market open to the Indian paper-maker at about 50,000 tons out of a total annual consumption estimated by the Board at 100,000 tons.

The staple material of the paper-maker in India was until recent years *sabai* grass, which grows abundantly in northern India. Indian wood has not yet been used to make paper, and pulp is imported from Europe. For the cheaper kinds of paper, jute waste and waste paper are used. The Indian Paper Pulp Company was the first to make paper from bamboo pulp. *Sabai* grass grows in scattered tufts intermixed with other vegetation and is affected by unfavourable seasons. The yield of bamboo per acre is larger than of grasses and the cost of production is smaller. Bamboo is easily available in Bengal, Orissa and south-west India. For the great bulk of the paper consumed in India, bamboo fibre is quite good enough, though inferior to *sabai* grass in strength and durability, and as a result of the researches carried out at the Forest Research Institute great expectations have been raised regarding the future of the bamboo paper pulp industry. The industry has been working under certain disadvantages, such as the high cost of chemicals, heavy transport charges for coal, and severe foreign competition from Scandinavia, Germany, the United Kingdom, Austria, Japan, and the U.S.A. This competition

[1] *Eastern Economist*, 19 July 1946, p. 111.

was however largely eliminated, if only temporarily, after the outbreak of war in 1939.

§33. **Protection to paper.**—The Tariff Board of 1924 recommended a protective duty of 1 anna per lb. for five years on certain classes of writing and printing paper competing with Indian paper. In 1925 the Bamboo Paper Industry (Protection) Act was passed providing for the imposition of a protective duty of 1 anna per lb. for seven years until 31 March 1932, so as to secure a firm basis for the industry. The Bamboo Paper Industry (Protection) Act of 1932 renewed the protective duty up to 31 March 1939 as recommended by the Tariff Board. The same Act imposed a new protective duty of Rs. 45 per ton on imported wood pulp to supply a definite stimulus to the manufacture and use of bamboo pulp. The question of continuing protection to the paper industry beyond 31 March 1939 was the subject of an inquiry by the Tariff Board in 1937-8. The Government of India decided to continue protection to the industry but at a rate lower than that recommended by the Board,[1] and gave effect to their decision by the enactment of the Indian Tariff (Second Amendment) Act, 1939. The period for which protection was granted was fixed at three years but was extended up to March 1947 when the protective tariff was abolished.[2] The duty on wood pulp was fixed at Rs. 30 per ton or 25 per cent *ad valorem*, whichever was higher. The protective duty on paper was fixed at 9 pies ins ead of 11 pies per lb.

India depends on imports from abroad for the supply of newsprint and certain special types of paper such as litho and poster paper as well as for large quantities of old newspapers for packing purposes. Great stringency is being experienced owing to the inevitable decline in imports since 1939 and the tight shipping position which still persists. The varieties of paper produced in the country are subject to the Paper Control (Economy) Order of 1944 and large percentages are allocated for Government use. The shortage of supply for civilian use has been acting as a serious handicap especially to Universities and other educational institutions.

§34. **Glass manufacture.**—Glass-making is a very ancient industry, and reference is made to it by Pliny who speaks of the superior 'Indian glass' made from crystals. However, no traces survive of the ancient industry, and all that is certain is that in the sixteenth century it existed as an established industry but had not advanced beyond the stage of producing very inferior material utilized for the manufacture of bangles and, to a small extent, small bottles and flasks. Then as now there was a large demand for bangles in the country. More recently, between 1892 and 1893, five glass factories of the modern type were established, but they were all wound up sooner or later. Those started under European management struggled hard and survived longer, but the last of them failed in 1908. Another European attempt, also unsuccessful, was made in Madras in 1909.

The glass industry, however, seems to have a peculiar fascination for Indians, for, in spite of the previous failures, as many as sixteen factories on a small scale were started during the swadeshi period 1906-13 and were the products of Indian enterprise. Only three of these factories, however, were in operation in 1914, and

[1] See *Report of the Tariff Board on Paper and Paper-Pulp Industries* (1938), par. 71.

[2] Since March 1947, imported paper has been subject to an *ad valorem* duty of 30 per cent.

none of them was making a commercial profit, though the Talegaon factory in the Poona district, aided by the Paisa Fund, was paying its way on somewhat peculiar and non-commercial lines.

Two well-defined classes of the industry in its present stage can be distinguished: (i) the indigenous cottage (bangle-making) industry; and (ii) the modern factory industry. The indigenous industry is spread all over India but is chiefly concentrated in the Firozabad district of the United Provinces and the Belgaum district in the south. There is a large colony of bangle-makers and about sixty bangle factories in Firozabad. The 'silk' bangles imported from Japan have, however, been a serious rival to the home-made article.

The factory industry is still in a condition of infancy and its production is mainly confined to the manufacture of lampware and, to a less extent, bottles and carboys. As a result of the stimulus given during the war period (1914-18) by the demand for specialized glass passing through the Munitions Board, several factories succeeded in turning out glass tubing, flasks, beakers, Petri dishes and test-tubes; and a few works were started to meet the demands of scientific laboratories controlled by the Indian Medical Service.

In the course of the 1939-45 war the industry made considerable headway both as regards volume and variety of output.

In 1945, a glass panel was constituted by the Government of India to recommend steps for the planned development of the Indian glass industry. The panel has expressed the view that as glass is one of the key materials for industrial development a determined attempt must be made in the course of the next ten years or so, to put the industry on a level comparable to that attained by it in the advanced countries of the world.

§35. **Imports of glass.**—Before 1914 India imported glass and glassware valued at Rs. 190 lakhs, the principal imports being bangles, beads, false pearls, sheet and plate glass, lampware, bottles and phials, soda-water bottles, tableware, etc. Austria and Germany held a predominant position in the trade, their share being 57 per cent of the aggregate imports. During the war of 1914-18, the imports of bangles and lampware decreased and their place was partially taken by Indian wares. In 1929-30, imports were valued at Rs. 252 lakhs and mainly came from Japan, the United Kingdom, Germany, Belgium and Czechoslovakia, which shows that the Indian industry was still in a condition of infancy. The value of the imports receded from Rs. 252 lakhs in 1929-30 to Rs. 122 lakhs in 1931-2. In 1937-8 it increased to Rs. 152 lakhs, but declined to Rs. 125 lakhs in 1938-9, with Japan still retaining the foremost position in the trade.

In addition to foreign competition other difficulties are inexperienced control, lack of trained men, insufficient supply of essential materials like coal and soda ash, sand and lime, and inadequate finance. In 1932, according to the figures published by the Tariff Board, there were 59 glass factories, the chief centres being Bombay, Jubbulpore, Allahabad, Naini, Bijhoi, Ambala, Lahore and Calcutta. Allahabad and Naini in the United Provinces enjoy enormous advantages over other centres like Bombay owing to their location in the vicinity of raw materials and fuel supplies.[1]

[1] See Fox, *Notes on Glass Manufacture* [Bulletins of Indian Industries and Labour, No. 29 (1922)].

The fuel difficulty may be overcome by the supply of cheap electricity for working electric glass-furnaces, but this is not such an easy matter as used once to be fondly imagined. Labour difficulties are no doubt serious as the glass industry even in its simple form is highly technical and can be efficiently conducted only by scientifically trained managers and expert workmen. Useful work has been done by the Paisa Fund Glassworks at Talegaon in training glass-blowers, and the expansion of the industry under war conditions was chiefly due to the supply of men who came from this place, although the training given there leaves much to be desired. Railway facilities are also necessary.

§36. **Protection to the glass industry.**—The prospects of the glass industry have been improved as the result of the appointment of a Glass Technologist by the Government of the United Provinces. Satisfactory results have been achieved in manufacturing bulbs for electric lamps, glass-stoppered bottles, laboratory glass, etc. World War II also stimulated the industry. Two new factories were added in 1939, and imports have shown an appreciable decline. The claim of the glass industry for protection was referred to the Tariff Board in October 1931. The Board, which submitted its report in 1932, recommended the grant of protection for a period of ten years and outlined proposals for protective duties on sheet and plate glass, bangles, beads, false pearls, glass and glassware. The Government of India's decision, which was announced as late as June 1935, was adverse to the findings of the Tariff Board. They did not accept the plea for protection on the ground that the absence of indigenous supplies of raw materials (namely soda ash) constitutes a disadvantage to the industry which cannot possibly be balanced by any advantages which it possesses in other respects. They, however, postponed their final decision until the possibilities of tapping new sources of supply of soda ash were fully explored. In the meantime they decided to afford the glass-manufacturing industry a certain measure of relief by a rebate of duty on imported soda ash for three years. This decision of the Government of India caused great disappointment among the glass manufacturers and was the subject of adverse criticism in general. The Tariff Board, while admitting that satisfactory sources of soda ash were not yet in existence in India, did not consider that this fact in itself invalidated the claim for protection advanced by the glass industry.[1]

§37. **The cement industry.**—It is surprising that in spite of the large home market in India, favourable conditions for manufacture and the national importance of the industry, the cement industry occupied an insignificant position before 1914, and was not able to produce cement up to the requirements of the British standard specifications. Even before 1914 India consumed large quantities of cement, importing about 180,000 tons a year. The demand for cement rapidly increased after 1918 and now exceeds 1,000,000 tons a year. The use of ferro-concrete in bridges and for heavy structural work of all kinds is extending rapidly. It has even been said that the Steel Age is now giving place to the Cement and Ferro-Concrete Age.

The manufacture of Portland cement commenced in Madras as long ago as 1904. It was, however, not until ten years later that production on a large scale began. Three companies were formed in 1912-13; the earliest to start operations was the

[1] *Report of the Tariff Board* (Glass Industry), par. 39.

Indian Cement Company at Porbundar (Kathiawar), followed by the Katni Cement and Industrial Company (Central Provinces) and the Bundi Portland Cement Company (Rajputana). The industry developed especially under the patronage of the Government who purchased the great bulk of the output during the 1914-18 war. In the inter-war boom period, a number of companies were floated. The three old companies doubled their output and seven new ones were projected and six of them started operations by 1923. Thus the development was very rapid and the aggregate production increased from 945 tons in 1914 to 236,746 tons in 1924, the imports showing a decrease from 165,733 tons to 124,186 tons during the same period. The imports further declined to 112,000 tons in 1930-1 of which 63,200 tons was supplied by the United Kingdom, other principal sources being Japan, Germany, Italy and Belgium. In 1938-9 imports of cement showed a further drop and shrank to the low figure of 21,000 tons valued at Rs. 10 lakhs. The imports were 4,300 tons in 1940-1 valued at Rs. 6 lakhs. The country has now become almost self-supporting in this respect. Production of cement in India amounted to 593,000 tons in 1932-3. In 1937-8 it had nearly doubled. The quality of Indian cement is not inferior to that of the British product and it more than holds its own against the cheaper continental cement. The Indian cement industry took a great step forward in 1936 with the formation of an effective combine known as the Associated Cement Companies of India, Ltd. This striking merger of the ten principal concerns has improved the technical and commercial organization of the industry.[1] Negotiations for the merger of the rival companies have not materialized. The slackening of the building boom in many important cities, the levy of the Property Tax in Bombay and Ahmedabad, and the war-time increases in the price of steel have also had adverse effects on the immediate demand for cement in the country. On the other hand, although the 1939-45 war raised the cost of manufacture, it also opened up prospects of a substantial export demand. The cement industry is dominated by two groups of producers, the Associated Cement Companies and the Dalmia Group, which between them account for 85 per cent of the total production. The demand for cement has increased enormously during recent years and it is urgently necessary to expand the industry's capacity for production.

The Tariff Board found that the industry possessed natural advantages in respect of raw materials, but laboured under a considerable handicap with regard to fuel as most of the works are situated away from the coal-fields. Regarding markets, the Board points out that the up-country market is a naturally protected market for the Indian cement works, which, except for the Kathiawar factories, are above 300 miles from any port. Elsewhere, Indian cement has to face the competition of foreign supplies. However, as the principal market for cement in India is not up-country but in the ports of Bombay and Calcutta, most Indian factories are at a disadvantage here, being away from the ports.[2]

In 1924 the Tariff Board declined to recommend protection to the industry on the ground that it was suffering from overproduction and prices were determined by internal competition among the Indian manufacturers and not by the imports.

[1] Since then, while one unit (the Katni works) has closed down, two new factories have started operations.

[2] *Report of the Tariff Board* (Cement Industry) 1925, pars. 8-12.

It considered, however, that it would not be long before conditions became stable, and with a view to the removal of the handicap to which Indian cement is subject owing to the great distance of the factories from the coal-fields or the ports, recommended that legislation should be introduced authorizing the Government to pay bounties on cement consigned from Indian factories to certain ports or to railway stations within a specified radius of these ports, provided the payment of bounties did not lead to a reduction in the price of Indian cement in relation to the price of imported cement. The Government of India did not accept the principle of such conditional legislation and decided not to take any action on the report.

§38. **The match industry.**[1]—With the exception of the Gujarat Islam Match Factory in Ahmedabad founded in 1895, there was no successful manufacture of matches on a commercial scale in India before 1921. There has been considerable expansion in recent years as a result of the imposition, in 1922, of an import duty for revenue purposes on matches of Re. 1-8 per gross, or more than 100 per cent *ad valorem*. The industry commands a large home market, consumption being estimated at seventeen million gross a year. Labour is cheap and well able to manipulate the simple machinery. The most striking development has been the establishment, in view of the import duty, of match factories in India by the gigantic Swedish combine, which controls about seventy per cent of the world's total demand, and there has been considerable agitation by the Indian match manufacturers about the adverse repercussions of this dominant foreign concern on the indigenous industry. Regarding the claim for protection, the Tariff Board reporting in 1928 held that the prices of Indian matches were regulated by internal competition and the consumer got them as cheap as possible and that the industry would be able to resist world competition unaided. It recommended, however, that the current revenue import duty of Re. 1-8 per gross should be converted into a protective duty for an indefinite period so as to give assurance to the industry that it would not be deprived suddenly of the protection it had enjoyed so far. It held that the Swedish Match Company had been doing useful work in the expansion of the industry in India, but advised the Company to adapt itself to Indian nationalist and political sensitiveness by reconstructing itself with rupee capital and admitting Indian directors, and acknowledged the necessity of keeping a watch on the Company to see that it did not employ its large resources to establish a monopoly in India.[2]

The Assembly passed the Match Industry Protection Bill in September 1928 as recommended by the Tariff Board, by which a duty of Re. 1-8 was levied on a gross of boxes each containing 100 matches.[3] A duty of $4\frac{1}{2}$ annas was levied on every pound of undipped splints used for match-making, and of 6 annas per lb. on veneers used in box-making. A considerable section of public opinion in the

[1] The coal and salt industries are dealt with in vol. I, ch. ii, while the sugar and tea industries are dealt with in ch. vi of the same volume.

[2] The Board held that it was utterly impossible to build up a cottage match-making industry in India, in view of the competition of the mass production of factories. See *Report of the Tariff Board* (Match Industry), 1928, pars. 131-2.

[3] The imposition of an excise duty on matches in 1934 and the consequent changes in the import duties are dealt with in ch. xii.

country along with the Indian Chambers of Commerce was strongly opposed to the policy of the Tariff Board and the Government in allowing a foreign concern like the Swedish Match Company to avail itself of the advantage of protection without the statutory adoption of the usual precautions to safeguard Indian interests.

The Indian match industry, sheltered by a high tariff, has been able to meet India's domestic requirements, and imports of foreign matches are now small. Imports of match-making materials are diminishing, showing that the industry is meeting its requirements more and more from indigenous sources.

Cottage Industries

§39. **Causes of the persistence of small-scale production.**—Industrial advance at the present time is generally associated with the predominance of production on a large scale. However, it does not necessarily bring about the total extinction of small-scale industry. The increasing use of electricity instead of steam has tended to make the unit of production smaller without involving any sacrifice of important external and internal economies. Again, in every progressive society there are a number of articles, such as artistic products and many luxury goods, which do not lend themselves to standardized production. Further, many of the improvements in the material equipment of civilization give rise to a number of small establishments to keep them going. Finally, new ihdustries, so long as they are in an experimental stage, are first tried on a small scale and it is only when their success is demonstrated that they are organized on a large scale.[1] It thus comes about that even in the most advanced countries of the West, a number of small industries exist and flourish side by side with large-scale industries. The important part played by small-scale and cottage industries in the economic structure of Japan is well known.

§40. **Industrialization and cottage industries in India.**—In India, particularly under the present conditions, industrial expansion in the near future is likely to be marked by the multiplication of small-scale enterprises all over the country. This is, however, a different thing from saying that India's progress in industrialization will leave all the industries of the old type intact and in undiminished vigour. Some old, lifeless industries will almost always lie about the cradles of new-born modern industries, and we must expect that intense industrialization will be injurious to some of the handicrafts which exist at present. A brief account has already been given of the manner in which the economic transition in India has affected the various indigenous industries,[2] and it has been pointed out that the artisans were left to their own resources and had to meet the new situation as best they could without guidance or help from the State. Such neglect and indifference must be avoided in future. For full and orderly economic development India requires village-scale, medium-sized as well as cottage industries, and all these must be properly co-ordinated. It is only thus that the ideal of maximum production, full employment and equitable distribution of wealth can be pursued in the condi-

[1] Radhakamal Mukerjee, *The Foundations of Indian Economics*, p. 360.

[2] See vol. I, ch. v, §§21, 22, 25; also see *Report on the Survey of Cottage Industries in Madras Presidency* (1929).

tions prevailing in India. Maximum production cannot be achieved without large-scale industry. But the progress of modern industry, however rapid, cannot possibly give employment to the vast population of India. Hence the need for encouraging small industry. Small industry further makes for equitable distribution of wealth as contrasted with big industry which tends to concentrate wealth in a few hands. The purely human aspect of the question must also not be ignored. If industrialization or the growth of big industry means unemployment and distress to those engaged in old industries, the best way of dealing with the situation may often be artificially to assist the old industries to survive side by side with the new type of industry. Lastly, the experience of the recent war in China and Russia has amply proved that, for a country of continental dimensions like India, it is of vital importance, as a measure of security against possible invasion, to have her industries widely scattered in small units rather than confined to a few big centres.

The cottage industries of India may be divided into three classes as follows:

(i) Some of the old industries like hand-spinning have suffered almost complete extinction. But as we have already seen,[1] hand-spinning has some possibilities as an ancillary occupation to agriculture. (ii) There are other cottage industries whose products are competing directly with machine-made goods and which may be described as being in a state of suspended animation. Those who cling to them do so because of their unwillingness to give up their hereditary occupation, or because they are deterred by the hard conditions of factory work as at present organized, or it may be that a craftsman is forced to remain in his traditional vocation by 'the patron and incubus' of the petty artisan in India—the merchant-financier, who is interested in keeping him there indefinitely, so that he may recover his money and continue to exploit him.[2] (iii) The third category is that of cottage industries which do not suffer from inherent and irremediable weakness and may be fit to survive even under modern conditions. Those industries, for example, which are closely connected with agriculture and which require simple tools have generally nothing to fear from factory goods. There are also cases where the artisans have successfully adapted themselves to the new conditions and learnt to use superior raw materials and better tools. 'The weaver has taken to mill yarn, the dyer to synthetic dyes, the brass and coppersmith to sheet metal, the blacksmith to iron rolled in convenient sections, in each case with advantage to the artisan from lessened cost of production, which has greatly extended his market. In some districts in Lower Bengal, the weavers use the fly-shuttle slay extensively and they have recently adopted it in large numbers in the coast districts of the Madras Presidency; while it is also gradually coming into use elsewhere. The tailors invariably employ sewing machines, and town artisans readily take to improved tools of European or American manufacture.'[3] Again, the economic strength of some of the handicraftsmen is due to the fact that the goods they turn out are of such a character that they allow no scope for the employment of automatic machi-

[1] See vol. I, ch. viii, §19.

[2] For fuller particulars regarding the financial and other handicaps of cottage industries, see *Report of the Bombay Economic and Industrial Survey Committee*, pars. 106-42.

[3] *Industrial Commission Report*, par. 255.

nery and large-scale production, or are not any cheaper or better for being machine-made rather than hand-made. Also, popular taste may require too great a variety for the goods to be profitably turned out on a large scale by means of modern mechanical appliances. Proximity of the market and a more intimate knowledge of the consumers' wants may also turn the scale in favour of the cottage worker. Further, the self-sufficiency of the village, though no longer preserved in its entirety, is not altogether a thing of the past even now, particularly where the railway has not yet penetrated, and consequently some of the artisans still continue to occupy their old recognized place in the corporate organization of the village and serve the simpler needs of the village-folk as in the days of yore, receiving their remuneration in the manner already described.[1] However, the self-sufficiency of the village is being invaded more and more, and as it disappears the position of these artisans will need to be adjusted.

Modern industry has made only a moderate advance in this country so far. Workers in the various cottage industries still form a large percentage of the population in almost every town and village. Their numbers are still vastly larger than those of the operatives employed in organized industries.[2] And while striving for rapid industrial expansion we must watch it with reference to its effects on the welfare of these numerous humble artisans throughout the country. We shall now proceed to examine briefly the present position of some of the most important of existing cottage industries in India.

§41. The cotton hand-loom industry.—The extent and importance of the hand-loom industry are not generally appreciated. The Cotton Textile Tariff Board in its Report published in 1932 estimated the number of hand-looms at 1,984,950 while the census of 1931 returned 2,575,000 workers as being engaged in cotton and silk weaving and spinning.[3] And though it is no longer true that 'everyone from the Cape of Good Hope to China, man and woman, is clothed from head to foot in the product of Indian looms' (Pyrard), and though the present position of the industry is far from satisfactory, it has a great future before it if suitable measures are taken to organize it properly.

There is no gainsaying the fact that hand-loom weaving has suffered—and in some cases suffered severely—on account of the competition of mill-made goods, and the weaver has had no chance of success when pitted against large-scale organizations, turning out exactly identical articles at a much smaller cost. In these circumstances, the weaver has had to abandon his calling in favour of agriculture, often joining the ranks of landless labourers, and is forced to lead a very precarious existence with even less power of resistance against famine and scarcity than the ordinary cultivator. His position is, however, stronger in the case of goods which are either too coarse or too refined and artistic and as regards which the hand-loom

[1] See vol. I, ch. v, §14.

[2] See *Industrial Commission Report*, par. 255.

[3] For an excellent summary of the present position of the cotton hand-loom industry in the various provinces see *Report of the Central Banking Inquiry Committee*, par. 299. See also *State Action in Respect of Industries*, 1928-35, ch. iii. For a recent (1940) review of the industry in the Bombay province see the *Report of the Bombay Economic and Industrial Survey Committee*, pars. 70-3.

can hold its own against machinery. The poorer classes, especially the villagers, prefer the hand-loom cloth as it is supposed to be stronger and more durable than anything of the same kind produced by the mills. The mills cannot take up the manufacture of the large number of specialized types of cloth, the use of which is decreed by slow-moving Indian custom, because, although the demand in the aggregate is large, the demand for each type is too small to make its manufacture in a factory economically worth considering. There is, of course, also the case of the finest fabrics of genuine artistic excellence where individual skill is required. There is thus a clearly demarcated field where the handicraftsman remains supreme and which cannot be usurped by the factory. The table on page 23 shows an increase in the Indian hand-loom production between 1905-6 and 1941-2 from 108 crore yards to 207 crore yards. This means that the hand-loom supplies about one-third of the total dem nd for cloth in India. The inability of the Indian mills to make up adequately the deficiency of imported cloth during the war of 1914-18 and the very high prices of mill-woven cloth after the Armistice were factors which substantially helped the weaver. After 1922, however, the weaver suffered by foreign (especially Japanese) competition and increased competition of Indian mills; though the more skilful and enterprising men have taken to silk-weaving and lace work. Altogether the hand-loom weaving industry has displayed a surprising degree of vitality and adaptability.

The weaver working in his own home works longer hours than the factory labourer, and also has the advantage of unpaid assistance from the women in the family in the intervals of domestic work. He is moreover content with a very small margin of profit as his standard of comfort is low. While this is a factor which increases his competitive power, its existence is not a matter for congratulation. The aim of reform ought to be so to improve the efficiency of the hand-worker as to enable him to adopt and maintain a higher standard of life. Although there are sound economic reasons for hoping that he ought to prosper if he confines himself to his proper sphere of work where the factory cannot trench on his dominion, his actual position is one of extreme poverty and distress. Early in 1941, the Government of India appointed a Fact-finding Committee (Hand-loom and Mills) to collect factual data as a preliminary to concerting measures for helping the hand-loom weaving industry. The report of this Committee reveals that the cost of production of the industry is high and the return to the weaver is much less than reasonable owing to the high margin of profit usurped by a chain of middlemen.

Under the inspiration of Mahatma Gandhi, the All-India Spinners' Association did valuable work in promoting the hand-loom industry. Since 1934 the Government of India have also initiated a policy of active encouragement to the industry by extending financial assistance to the activities of Provincial Governments in this behalf.

With the object of improving the position of the industry a body called the All-India Hand-loom Board has recently been constituted on which the weaver, the Provincial Governments and the States interested in the industry are represented. The recommendation of this Board that the yarn supply to the industry should be assured and increased by reserving for it half the production of the spindles installed during the first five years of the post-war development plan, was

accepted by Government. Proposals for organizing the industry on a sound footing by rationalizing and standardizing its products and consolidating its markets are under active consideration. A scheme is also being evolved for ensuring free inter-provincial movement of hand-loom cloth to enable the industry to regain its pre-war markets within the country.[1]

§42. **The woollen industry.**—The manufacture of woollen goods in some shape or form is found in all parts of the country for the simple reason that the sheep is a ubiquitous animal, though the quality of the wool varies from place to place, the sheep in the hilly tracts generally yielding wool of finer quality than those in the plains. The woollen hand-loom industry gives part-time employment to about 40,000 people.

Under the Moguls the manufacture of woollen carpets had reached a high pitch of excellence. The demand for woollen carpets came mainly from the royal courts and the nobility, and the industry found its natural habitat in the principal capital cities, though it migrated to other centres on the break-up of the Mogul Empire. The downfall of the Empire practically extinguished the local demand for carpets, but it was gradually replaced by foreign demand after the establishment of British rule. The foreign demand, however, although it helped to stay the economic ruin of the artisans, was responsible for a deterioration in the quality of the goods. It encouraged the production of cheap articles fashioned according to patterns sent out to India from abroad. The growing use of aniline dyes was a further cause of deterioration. The opening of the foreign markets also led to the appearance of a large number of middlemen, which is the characteristic feature of trade in modern India, especially of the export trade. Carpet-weaving in India at the present time depends almost entirely on foreign demand, which absorbs as much as 90 per cent of the total production.

Considered as a cottage industry, carpet-weaving is in a languishing condition on account of the ignorance and poverty of the weaver and the absence of organization.[2] It is usual for the weaver to accept advances of money from the dealer, and the system of advances tends to convert the independent handicraftsman into a bond slave of the dealer and destroys personal interest in the work and incentive for improvement. Also the weaver is not able to take his labour or goods to the best possible market but must work according to the dictation of the dealer.

The manufacture of shawls had attained great renown in India in the pre-British days, especially in Kashmir and the Punjab, and the Moguls were particularly interested in its development. The famine of 1830 dealt a severe blow to the industry from which it never quite recovered and its difficulties were enhanced by the numerous imposts to which it was subjected in the Kashmir State. The development of an export trade to Europe which began in the early years of the nineteenth century was helpful in arresting the decline of the industry and is supposed to have at one time provided employment for over 15,000 workers. The Franco-German war of 1871, however, was responsible for an abrupt shrinkage of the European demand. Nor was this sudden check temporary in character, for shawls rapidly went out of fashion in Europe and in spite of the close of the war

[1] *India and Pakistan Year Book*, 1949, p. 422.

[2] A certain amount of carpet-weaving is also done in the Indian jails.

no revival was experienced by the trade. Another important factor which contributed to this result was the starting of shawl manufacture at Paisley in Scotland.

Another woollen manufacture that is widely prevalent in the country is that of the coarse rough blanket (*kambli*), which is put to such a variety of uses by the humble folk in the villages and 'serves as bed, portmanteau, overcoat or umbrella'. The production of blankets is generally a by-occupation pursued by shepherds or agriculturists who are mostly Hindus. There is no export trade in these articles but the industry is nevertheless important because of the large number of people engaged in it. It is immune from the competition of machine-made goods, which cannot stand the rough wear to which the *kambli* is subjected. Having regard to the facility with which the raw materials can be obtained in every part of the country and the largeness of the home market, blanket-weaving would appear to hold out great promise as a cottage industry and its possibilities should be systematically explored.

The woollen hand-loom industry benefited much by the big army orders for blankets during the 1939-45 war. As the woollen mills were working to capacity to fulfil orders placed through the United Kingdom, the hand-loom found an appreciably widened local market for its products. This war-time prosperity however, has proved to be short-lived. Co-operative production and marketing nevertheless hold out a promise of renewed health and activity.

§43. **Sericulture and silk manufactures.**—Whatever success sericulture has achieved in India has been confined to those parts of the country, like Bengal, Kashmir and Mysore, where the requisite conditions, such as an adequate stock of mulberry trees and ample labour supply, are available.

Roughly, during the first three-quarters of the seventeenth century the East India Company was primarily interested in the trade in raw silk. Subsequently the Company realized that greater profits were to be made by exporting Indian silk manufactures to England and they pursued this policy with sufficient vigour and success to alarm weavers in England. Owing to the opposition of English weavers and for other reasons, the East India Company once more reverted to the trade in raw silk. The policy of favouring the production of raw silk and discouraging that of manufactures had an adverse influence on the indigenous weaving industry.[1] Its position was further worsened by causes similar to those accounting for the decline of the woollen manufactures of carpets and shawls, namely, a change in the nature of the European demand and the progress of silk-weaving in Europe, which soon outstripped the Indian industry as regards technique. To this list of causes must be added the emergence of Japan, China and the United States as competitors in the European markets; and as regards the local market, the demand for the products of the hand-loom was diminishing among the educated and well-to-do classes who as patrons have taken the place of the old nobility and the royal courts.

In short, both sericulture and silk-weaving have suffered in India in recent times. India's exports of the raw material have not only decreased in volume but

[1]. The decline of the silk industry is indicated in a striking manner by figures for the export trade. The value of the export of silk manufactures in 1886 was Rs. 32,96,000; in 1941-2 it amounted to only Rs. 2,66,000.

have changed in form. Most of the silk exported at present is in the form of waste or cocoons. The reeling is so badly done in India that foreign countries prefer to take the cocoons from this country and do the reeling themselves. The same reason explains the increasing popularity of imported silk in India. The Indian weavers themselves prefer the more evenly reeled Chinese or Japanese silk to the home-made product. Efforts are being made to improve the quality of Indian silk. The Agricultural Department in Bengal runs two sericultural schools. Attempts are also being made in Assam and the Indian States of Kashmir and Mysore to encourage sericulture. In 1935 the Government of India established the Imperial Sericultural Committee, and grants amounting to Rs. 93,000 as recommended by it were allotted to various provinces to enable them to set up schemes for the benefit of sericulture in Bengal, Assam, Madras, Bihar and Orissa and Burma.[1] The schemes are designed to increase production of disease-free seeds and to help in investigating questions connected with silk-worm disease. An annual grant of Rs. 1,00,000 for five years from 1 April 1935 to 31 March 1940 was made by the Government of India. Imports of artificial silk yarn had been rapidly increasing in recent years. The increase between 1922-3 and 1928-9 was from 225,000 lb. to 7,700,000 lb. The imports in 1937-8 reached the record level of 31·6 million lb. valued at Rs. 205 lakhs. In 1938-9 imports amounted to 17·2 million lb. valued at Rs. 96 lakhs. The figures for 1941-2 were 13·7 million lb. valued at Rs. 155 lakhs. Japan dominated all branches of the import trade, but in consequence of the depression in the artificial silk industry in that country and the difficulty of obtaining the raw material after the outbreak of the Sino-Japanese war, Italy, before she entered the war in 1940, had displaced Japan from the foremost position. Reduced prices and improved quality have contributed to the increasing popularity of rayon products. Japanese imports were again on the increase before Japan joined the war. As to silk-weaving, the indigenous industry has been steadily losing ground to manufactures from abroad because of inefficient organization, the hopelessly inadequate resources of the average weaver and his antiquated methods of production. The manufacture of silk goods as a cottage industry enjoys certain exceptional advantages in the existing circumstances in India. Large-scale production with modern mechanical appliances is relatively more difficult than in the case of cotton manufactures and has hardly yet made a beginning in this country. Besides, silk manufactures, being largely of the nature of luxury goods in India, admit of a great diversity in workmanship. As regards imports of finished goods from abroad, the home industry is sheltered in a large measure by the high import duty on manufactured goods. Lastly, there has been in recent years the growth of a well-marked tendency on the part of Indians to extend a patriotic preference to indigenous as against foreign goods. Circumstances would thus seem to be propitious for reviving the silk cottage industry.

It may be mentioned in this connexion that the Indian Tariff (Textile Protection) Act, 1934, imposed protective duties on raw silk, silk yarn, piece-goods and mixtures as well as on fabrics of artificial silk and mixtures; in addition, the duty on artificial silk yarn, which competes with silk yarn, was raised to 25 per cent

[1] See *India in* 1934-5, p. 25.

ad valorem with an alternative minimum specific duty of 3 annas per lb. In April 1940 the existing protective duties on silk and silk manufactures were extended for a further period of two years. In 1942, the original recommendations of the Tariff Board (1938) for five years' protection to the Indian silk industry and for an all-round increase in the import duties were adopted, and protective duties were raised to 25 per cent plus 14 annas per lb. plus one-fifth of the total duty for a period of five years.

§44. **Other cottage industries.**—The present position of different cottage industries has already been indicated in the chapter 'Economic Transition in India' (vol. I, ch. v), while the cottage branches of the oil-milling, tanning, glass-making and match-making industries have been noticed in our treatment of these industries. The position and prospects of subsidiary agricultural industries have also been discussed under Agricultural Organization (vol. I, ch. viii). There are numerous other cottage industries such as embroidery work, the furniture, metal and cutlery, gold and silver thread industries, pottery, soap-making, cap-making, doll- and statuette-making, bead manufacture, etc.[1]

§45. **Methods of aid to cottage industries.**[2]—The ignorance and poverty of the small artisan make it necessary that a comprehensive scheme for assisting him must be elaborated and put into operation. The first obvious step is better general education which should make some attempt to provide manual training and instruction in industrial crafts. The Bombay Economic and Industrial Survey Committee recommended that basic education through the media of crafts should be introduced, particularly in rural areas.[3] Over and above this, provision for the education of the artisan in special industrial schools, preferably controlled by the Director of Industries, is necessary. The Industrial Commission also recommended that, for the training of the more intelligent artisans, demonstration hand-loom factories assisted by the Government should be started, and a commercial section should be attached to the weaving schools, so that enterprising artisans so trained might be fitted to start small hand-loom factories on their own account. The jails and reformatory schools make a speciality of teaching various industrial crafts to their inmates, such as carpentry, cane and bamboo work, etc., with the object of enabling prisoners to set up as craftsmen after they are discharged. One of the handicaps from which the cottage industries often suffer is the difficulty of obtaining cheap raw material of good quality. The necessity of improving the quality of indigenous cotton and silk, for example, is obvious from this point of view. Another needful reform is the invention and introduction of more efficient tools and implements. In Bihar and Orissa demonstrators conduct peripatetic

[1] For an interesting description of the various cottage industries in Madras see *Report on the Survey of Cottage Industries in Madras Presidency*, for those in Bombay see *Report of the Bombay Economic and Industrial Survey Committee* (1940), pars. 64-105 and for cottage industries in the United Provinces, see *Report of the Cottage Industries Sub-Committee, United Provinces*, 1947, (Appendix I, p. 65) which mentions as many as 68 industries in that province carried on in the homes of the artisans without the use of mechanical power.

[2] See Clow, op. cit., ch. vi, *Report of the Central Banking Inquiry Committee*, par. 300, and *Report of the Bombay Economic and Industrial Survey Committee*, pars. 143-79.

[3] *Report*, par. 234.

demonstrations of improved appliances. These demonstrations are based on the Cottage Industries Institute which carries out experiments in its various sections, arranges for the supply of looms, dyes, accessories, etc., and introduces new cloths and new patterns among weavers. Similar services for the silk industry are performed by the Bhagalpur Silk Institute, while the experimental blanket factory at Gaya is attempting to do the same for the primitive blanket industry in the south of the Patna Division. In the Central Provinces the Department of Industries is carrying on a campaign to introduce improved slays among weavers. Valuable assistance can also be granted by providing technical advice and facilities for technical training, and by giving the artisans new patterns and designs to work upon so as to increase the sales. The Bombay Economic and Industrial Survey Committee recommended the establishment of a Provincial Cottage Industries Research Institute, under the Deputy Director for Cottage Industries, to study problems of interest to cottage industries. The Institute will not only attempt to improve the tools and existing methods of manufacture, but will also explore the possibilities of starting new cottage industries (par. 213).

By way of providing the handicraftsman with the requisite capital, the Industrial Commission suggested that in some cases small loans should be given by the Director of Industries, or that tools and plants should be supplied on the hire-purchase system so that they become eventually the property of the artisans. But the most promising solution of the problem is afforded by co-operative credit. The principle of co-operation is of very fruitful application[1] for the purpose of bettering the lot of the small artisan, whether by providing loans at a moderate rate of interest or helping him in the purchase of raw materials, tools and implements and in the sale of the finished article.

Another weakness of the present system is the absence of an effective marketing organization. The artisan fails to get the best price for his goods, being unable to advertise his wares properly. The Arts and Crafts Emporium at Lucknow and similar shops in Madras are intended to remove this handicap to some extent but many more such emporiums are required. The toy industry of Germany and the cottage industries of Japan owed their success to the existence of the essential business organization which took over the produce of the industries and disposed of it within the country as well as abroad. At present the foreign markets are neglected in India and even the home market is not properly nursed. The Swadeshi Stores in Bombay form a good example of an active and successful agency for internal distribution of indigenous products and furnish a type worthy of imitation. The Department of Industries, Bombay, has opened a Sales Depot in Bombay for popularizing the products of cottage industries. To the same end, the Bombay Economic and Industrial Survey Committee recommended the holding of periodic exhibitions and the creation of permanent museums.[2]

The question of marketing hand-loom products was considered at the sixth Industries Conference (1934) and promising schemes which are based on co-operative effort have since been adopted by several of the Provincial Governments such as Madras, Bombay, the Central Provinces and Berar, Bihar and Orissa. In

[1] See vol. I, ch. x, §§ 10 and 15.

[2] *Report*, par. 208.

Bombay, eight Co-operative Industrial District Associations have been formed at important centres. Each Association has a shop of its own which accepts on consignment account against partial advances, and sells, on a commission basis, the products of hand-loom weavers. A marketing officer and a textile designer have also been appointed.[1] The Bombay Economic and Industrial Survey Committee recommended that each district should have a District Industrial Association in charge of a District Industrial Officer assisted by a local Advisory Committee.[2]

One often hears complaints about the deterioration of artistic taste among the people of this country including the educated classes. Wide advertisement of artistic indigenous products will not only benefit the handicrafts, but will also assist the formation of a more discriminating taste among the people.

Another way in which the Government might help is by extending their patronage to the cottage industries. The Provincial Stores Purchase Department in the United Provinces, for instance, has accepted this policy and buys goods whenever possible from local manufacturers. The execution of a stores purchase policy with a cottage bias was also recommended by the Bombay Economic and Industrial Survey Committee.[3]

Reference has already been made to the State Aid to Industries Acts passed by various provinces and the more liberal interpretation given to the rules governing the grant of financial assistance to small industries in Bombay. Substantial State help and initiative over a prolonged period are essential, and in the beginning State management is also necessary to enable the cottage industries to overcome their difficulties. There is also need for a positive industrial policy and for industrial planning by the State with the assistance of an Economic Development Department.[4]

§46. Recent measures of State help to cottage industries.—The Government of India have in recent years keenly interested themselves in the promotion of cottage industries in India, especially the cotton hand-loom industry and the sericultural industry. The sixth Inter-Provincial Industries Conference held in July 1934 discussed schemes submitted by the various Provincial Governments for the development of the hand-loom industry, the premier cottage industry of the country. The Government of India announced at the Conference that they had decided to spend about Rs. 5 lakhs every year for five years for the development of the hand-loom industry.[5] The schemes in the several provinces thus financed are of a varied character. They include the training of weavers in improved methods of production, the establishment of sale depots and weavers' co-operative societies for marketing hand-loom products, and the introduction of new patterns, new designs and improved appliances. The grants to the provinces are allocated on the basis of provincial expenditure and the consumption of yarn. The seventh Industries Conference also decided in favour of holding exhibitions of hand-loom

[1] For further particulars regarding the various marketing schemes, see *State Action in Respect of Industries*, 1928-35, pp. 26-9, and *Report of the Bombay Economic and Industrial Survey Committee*, par. 156.

[2] *Report*, pars. 209 and 212.

[3] *Report*, par. 214.

[4] *Report*, pars. 208 and 231.

[5] *State Action in Respect of Industries*, 1928-35, p. 20.

machinery and fabrics.[1] We have reviewed the measures adopted by the Government of India to encourage and protect the sericultural industry. Early in 1936, the Government of India, while declining to accept the Tariff Board's recommendation in favour of granting protection to the woollen (mill) industry, announced their intention of asking the Assembly to sanction a grant of Rs. 5 lakhs, to be spread over five years, for the benefit of the cottage industry.

Those Provincial Governments under the Congress Ministers set up in 1937 devoted particular attention to the revival of cottage industries. The All-India Village Industries Association, established in 1935 under the auspices of the Indian National Congress, and the National Planning Committee, set up in 1939 by the Working Committee of the Congress, also served to attract attention to the importance of cottage industries in any scheme of economic planning for the country. As was to be expected much thought and discussion is at present being given by the Governments both in India and Pakistan to the question of cottage industries, although their position has not greatly improved since the attainment of independence.

[1] Proceedings of the seventh session of the Industries Conference held at Delhi, October 1935.

CHAPTER III

INDUSTRIAL LABOUR

§1. Growing urgency of labour problems.—Owing to the slowness of our industrialization, our labour problems are not so formidable as in the West. But the time is not far distant when they will assume similar dimensions. The war of 1914-18 led to a new mass awakening, making the workmen more and more conscious of their importance and rights. The rise in prices during the war and after, by greatly increasing the cost of living, led to labour unrest and forced labour to organize itself in order to safeguard its interests. The Indian labour movement is now linked up with the international labour movement, and India's labour representatives attend the International Labour Conference that is held annually. India has been recognized as one of the first eight countries of industrial importance by the League of Nations. The national importance of ensuring an adequate supply of an efficient and contented labour force in industries is being understood more and more by the Government and the people. This was attested by the appointment in May 1929 of a Royal Commission on Labour presided over by the late Rt. Hon. J. H. Whitley. The recommendations of the Whitley Commission have been accepted as the foundation for the Government's labour policy and have powerfully influenced recent labour legislation.[1] Another factor which exercised a decisive influence on the labour policy of the Government was the advent of Congress ministries in a number of provinces in the middle of 1937. We may in this connexion invite attention to the press note which the Government of Bombay issued in August 1937 explaining their policy in respect of the industrial worker. 'The aim of the Government is to try and adjust the social and economic mechanism in such a way as to assure to the worker the satisfaction of at least his minimum human needs, security of service, provision of alternative occupations in periods of unemployment and maintenance during periods of incapacity for work.'[2] The Bombay programme has been accepted as the basis of an all-India labour policy. The Congress ministries had shown much activity in the sphere of labour legislation. Their resignation in November 1939 necessarily brought about a slackening of this activity. At the same time the war has again brought the labour problem into prominence, as the workers, being now better organized than during the previous war, have in many industries successfully demanded 'dearness allowances' and other concessions.

§2. Supply of industrial labour and its migratory character.—The factory labourers in India do not constitute a wage-earning class exactly corresponding to the factory labourers in the Western countries, where the labourers form a permanent class of industrial workers completely divorced from the land. Most of them have been brought up in the towns and some have abandoned the

[1] The Whitley Commission's Report, which was published in June 1931, is referred to throughout this chapter as *L.C.R.* The figures refer to pages of the Report. Thus: *L.C.R.*, 4=*Labour Commission Report*, p. 4.

[2] *Labour Gazette*, Bombay, August 1937, pp. 891 and 922-4.

country permanently for the towns. The superiority of the industrial worker in the West is to no small extent due to his early upbringing in a factory area. The Indian factory operative on the other hand is generally a migrant and he rarely severs his connexion with his village.[1] It is not true that the typical Indian factory worker is essentially an agriculturist who has only temporarily forsaken his agricultural work in order to add to his income by a brief spell of industrial work in the city. The conception of the short-term recruit from agriculture is kept alive by the fact that a number of new recruits revert quickly to the village and the fact that the average worker does not remain in one factory for any length of time. The great majority of Indian workers in industrial centres are, however, at heart villagers with a village upbringing and village traditions, and most of them intend to get back, and succeed in getting back, to their villages. Agriculture supplies the bulk of the recently established industrial population though some of it is drawn from the different village crafts also. The proportion of factory workers deriving some pecuniary benefit from agriculture is not so large as commonly supposed. Many of them have only an indirect interest in agriculture. For example, they may be members of a joint family having an agricultural holding or may have close relations actively engaged in agriculture. Most industrial workers are born in villages and spend their childhood in villages—a tendency strengthened by the raising of the minimum age for industrial employment. Many workers leave their families behind them in their village and even when the wife accompanies the husband to the city she is generally sent back to the village for confinement. The numbers of workers supplied from the rural areas are increasing with the steady expansion of Indian industry. The labourer visits his village as often as financial circumstances permit. When he returns to the village, however, it is not necessarily in order that he may assist in the agricultural operations. He may prefer to remain unoccupied and enjoy a holiday as long as he can. Whilst in the city he maintains contact with the village in so far as he has to send remittances to his family or relations or his sahukar.[2]

The causes of the migration of labour from the villages to the towns may be briefly examined. The growing class of landless rural labourers are the first to feel the pinch of agricultural distress, and improved means of communication enable them to leave the villages in search of work and higher wages in the factories, workshops, dockyards, mines, plantations and the great public works like railways and irrigation. In some provinces, for example, the United Provinces, Bihar, Orissa, and certain Districts like Ratnagiri in Bombay, the density of the population and the pressure on land are so great and the evil of uneconomic holdings has assumed such serious proportions that the petty landholders are under the necessity of migrating every year to the towns in order to eke out a livelihood. The joint-family system also facilitates such migration, as some members of the family can leave the village without having to break up their home or give up their land, as these can be left in the charge of other members who remain behind. Sometimes the agriculturist may seek employment in the towns to evade the village money-

[1] For instance, 84 per cent of the inhabitants of Bombay were returned by the census of 1921 as having been born outside the city. The percentage declined to 75·4 in 1931, but there is some doubt as to whether the returns were accurate in this respect.

[2] *L.C.R.*, 11-14.

lender or to earn enough for buying cattle or more land. Sometimes again t age menials and drudges belonging to the depressed classes migrate to town hope of bettering their prospects. Distress and not ambition being the chi we may hazard the statement that those who migrate to the cities are mo than not the least competent and the most helpless of the village populat the Labour Commission observe: 'The driving force in migration comes almost entirely from one end of the channel, that is, the village end. The industrial worker is not prompted by the lure of city life or by any great ambition. The city, as such, has no attraction for him and, when he leaves the village, he has seldom an ambition beyond that of securing the necessities of life. Few industrial workers would remain in industry if they could secure sufficient food and clothing in the village; they are pushed, not pulled, to the city' (*L.C.R.*, 4).

§3. **Effects of migration.**—As a result of migration many sections of factory workers find themselves in an entirely unfamiliar environment of customs and traditions, and even the language may be different. The force of old customs and sanctions is weakened. 'The ties which give village life its corporate and organic character are loosened, new ties are not easily formed, and life tends to become more individual.' The health of the worker may be subjected to a severe strain owing to radical difference of climate, a defective dietary, excessive congestion and lack of sanitation, or the temptations of enforced separation from his family. The worker is further demoralized by certain evils, comparatively unknown in the villages, such as drunkenness and gambling. As regards conditions of work, the worker finds himself subjected to unaccustomed strain of body and mind owing to disciplined hours of continuous toil instead of the spasmodic work with long intervals of rest to which he has been used. These hardships are more than many new recruits can bear and compel them to return to their villages. As the labourer desires ultimately to return to his village home, he is unable to develop a permanent interest in his employment in the city and this is probably one of the reasons which prevents him from acquiring a high standard of technical efficiency. His frequent absence from work owing to his repeated visits to his village or to other causes makes it difficult to establish contact between employers and employees and militates against any form of effective organization among the workers themselves. The worker who returns after a period of absence has no guarantee of re-employment after his return, and difficulties of reinstatement often place him at the mercy of the money-lender, the jobber or the labour supplier, the foreman and the liquor-seller.[1]

However, according to the Labour Commission, contact with the village is not without its advantages. In so far as the industrial workers have been brought up in healthier surroundings they bring with them a better foundation of physical health than could be built up in the cities. The periodical migrations to the village are also a great help in recuperating mental and physical energy. The home in the village is a convenient shelter to the labourer and his family in case of unemployment, sickness, etc. The village provides some kind of insurance against unemployment in the towns just as the towns help in easing the economic pressure in the villages. The combination of urban and rural life is beneficial to the town as well

[1] See B. Hurst, *Labour and Housing in Bombay*, Foreword by Sir Stanley Reed, pp. v, vi.

as to the village. It serves to diffuse in the countryside a wider knowledge of the outside world and helps the villager to liberate himself from the fetters of custom and prejudice as it enables the townsman to obtain a valuable insight into the realities of Indian life. In these circumstances the Labour Commission give it as their considered opinion that at the present stage the link with the village must be regarded as a distinct asset and that the aim should be not to undermine it but rather to encourage and regularize it.[1]

§4. **Scarcity of industrial labour.**—We have already referred to the alleged scarcity and dearness of labour.[2] The true explanation of any scarcity that may be felt must be sought in the appalling housing conditions in towns like Bombay, low wages and high cost of living, and absence of a suitable labour-recruiting organization. All these causes have from time to time been reinforced by the heavy mortality caused by famines, and epidemics like plague and influenza. The migratory character of industrial labour further emphasizes the feeling of labour scarcity. Skilled labour is particularly difficult to get and this is due to the very meagre facilities that exist for training labour for modern industry. The scarcity of men of the *mistri* or foreman class, possessing the requisite technical and business experience, has also been ascribed to 'the average educated Indian's aversion to all forms of manual work'.

According to the Labour Commission, while organized industry in India has throughout the greater part of its history suffered from a shortage of labour, the position has tended to become easier, roughly since 1925. Communications have improved steadily so that labour can now be drawn from a wider area than before. Conditions of life in cities and the factories, although far from ideal, are generally improving. Owing to the spread of knowledge the village population is showing greater readiness to migrate while the pressure on land is showing no signs of abating (*L.C.R.*, 21-2).

§5. **Methods of recruitment.**—In this connexion a word may be said regarding the methods of recruitment. The mill management does not directly recruit the required labour. Personal recruiting by contractors going round the countryside may be necessary in exceptional cases, as in the Assam tea gardens, but it is no longer generally so. Still the foreman or jobber is usually the man through whom the labour is secured and who continues to act as an intermediary between employer and employee. Where the heads of departments are Europeans, the jobber is an indispensable link between them and the workers. His importance is also largely due to the aloofness of employers from trade union organizations. Some of his functions are like those of trade union officials in the West and occasionally he acts as a strike leader.[3] The jobber manages to make himself indispensable to the workmen in a variety of ways. He lends them money, advises them in family affairs and arbitrates in disputes. Since all labour is recruited through him, the newcomer generally finds that the only way of getting employment, temporary or permanent, is to bribe him. Extensive bribery known as *dasturi* (unacknowledged commission) prevails in the jute mills of Calcutta, and petty exactions may swell

[1] See *L.C.R.*, 17-20. [2] See vol. I, ch. iii, §24.

[3] The jobber is known in different parts of India by different names, such as *sirdar*, *mukaddam* or *mistri*.

the monthly income of the *sirdar* to four or five times his wages. Even the pay-clerks 'are known to reap harvests of this kind. The recruiting agent generally manages to keep a continuous hold on the recruit who is forced to pay him recurring sums of money under pain of losing his job. Women workers also share with men the burden imposed by the overseers, but are particularly liable to be oppressed, especially if they happen to be widows'.[1] In the Bombay cotton mills, it is usual to have women overseers, known as *naikins* or forewomen, in the departments where women work, such as the winding and reeling departments. They are as a class considered to be persons of low morals and often abuse their power over the young girls and women workers under them.

The general prevalence of the system of jobbers has been recognized to be a great evil. The only remedy is stricter supervision by the mill officers and direct control over recruitment, appointments and dismissals. Where the jobber is in the habit of exacting a bribe on all fresh engagements he is interested in seeing to it that such engagements are as numerous as possible and encouraging the movements of the operative from factory to factory. There is thus a close connexion between bribery and turnover. Jobbers should be excluded from the engagement or dismissal of labour. In pursuance of the Labour Commission's recommendation several large organizasions such as E. D. Sassoon & Co. and the Burmah-Shell Company have appointed special Labour Welfare Officers to recruit labourers and look after their welfare. The Millowners' Association, Bombay, have introduced what is known as the 'Badli Control System', under which vacancies are filled only from card-holders. The evil influence of the jobber is thus eliminated. Many jute mills have recently established Labour Bureaux one of whose main duties is to recruit labour.

The Cawnpore Labour Enquiry Committee urged the complete dissociation of *mistris* (jobbers) from recruitment of labour and recommended the establishment of a Labour Exchange under Government control, which would provide employment to applicants on demand from factories.[2] The Northern India Employers' Association, Cawnpore, has started an Employment Exchange on these lines. It would be desirable to introduce a system of regular leave, and holiday allowances should be introduced as this would tend to diminish the power of the jobber and create a contented and efficient labour force.[3]

The question of holidays with pay for industrial workers in India was one of the items discussed at the first Conference of Labour Ministers held in January 1940. Central legislation on the subject was favoured by the Conference.

§6. **Periods of wage payments.**—In most Bombay mills wages are paid once a month, usually on the eighth of the month next following the one for which wages are earned, so that a new recruit has to wait for six weeks before he can get his wages. This is a source of much hardship and accounts for a large part of the indebtedness of the factory population. In fact, indebtedness is as much a feature of town life as of village life. The millowner on his part pleads that holding wages in arrears is the only method of preventing his labour force from deserting him without notice. The system of monthly payments necessitates at least one month's

[1] J. H. Kelman, *Labour in India*, pp. 108-9.

[2] *Report*, pars. 139-40.

[3] *L.C.R.*, 23-7.

notice from a workman desiring to leave. Many new workmen, ignorant of this, leave without notice and thus forfeit a month's pay. Generally speaking, the longer the wage period, the more delayed is the payment of wages. In the Calcutta jute mills, weekly wages are paid and only a week's wages are held back. In Ahmedabad, wages are paid by the *hapta*, or intervals of fourteen to sixteen days.

Local Governments were asked in September 1924 to collect information on the periods of wage payments and this revealed the most striking absence of uniformity as to the method adopted from industry to industry and place to place. Even within the same establishment different systems may be found.[1] The Payment of Wages Act which was passed in April 1936, and came into force in March 1937, provides (i) that no wage period shall exceed one month,[2] (ii) that all wages must be paid in coin and/or currency notes, and (iii) that the wages of any person employed upon or in (*a*) any railway, factory or industrial establishment employing more than 1,000 persons shall be paid before the expiry of the seventh day, and (*b*) in any other railway, factory or industrial establishment, shall be paid before the expiry of the tenth day, after the last day of the wage period in respect of which the wages are payable.

§7. **Deductions from wages.**—The Payment of Wages Act also seeks to regularize and restrict deductions from wages. Deductions from the wages of an employed person may be of the following kinds only, namely, fines; deductions for absence from duty; deductions for damages to or loss of goods expressly entrusted to the employed person for custody, or for loss of money for which he is required to account, where such damage or loss is directly attributable to his neglect or default; deductions for house-accommodation provided by the employer; deductions of subscriptions to, and for repayment of, advances from any provident fund, etc.

Fines.—Fines can only be imposed on any employed person for certain specified acts and omissions on his part notified in the prescribed manner on the premises in which the employment is carried on. The total amount of fine which may be imposed in any one wage-period shall not exceed an amount equal to half an anna in the rupee of the wages payable to him. No fine shall be imposed on any employed person who is under the age of fifteen years.

While, as a result of this Act, the practice of fining has almost stopped, employers have found ways of circumventing the Act, e.g. by compelling workers to go on leave without pay and by introducing differential rates of wages, etc.

§8. **Hours of work and the loitering habit.**—One of the grievances of employers of labour in India has always been that the Indian millhand is incapable of steady and continuous work. He is given to loitering and loafing away his time under various pretexts. Men are often found to be absent from their machines,

[1] The information has been published in *Periods of Wage Payment* [Bulletins of Indian Industries and Labour, No. 34 (1925)].

[2] Amendments to the Payment of Wages Bill moved by Labour members to reduce the wage period to a week or fortnight were defeated, owing mainly to the opposition of the monthly-paid workmen, who argued that if rents and bills were to be settled monthly, they would be in difficulties if they had frittered away their weekly or fortnightly earnings.—*Indian Year Book*, 1944-5, p. 515.

and spare hands have to be employed to attend to the machines of the idlers. The Indian Factory Commission (1908) declared that 'while the Indian factory worker may work hard for a comparatively short period, his natural inclination is to spread the work he has to do over a long period of time, working in a leisurely manner throughout and taking intervals of rest whenever he feels disinclined for further exertion'. The excessively long hours of work—twelve to fourteen hours—which prevailed, especially before the passing of the Factory Acts of 1911 and 1922, are held to be the chief cause of loitering. Dr T. M. Nair in his Minute of Dissent to the Report of the Factory Commission calls it 'a manifestation of the adaptive capacity, which all human beings possess more or less, a device to reduce the intensity of labour as a safeguard to his physical well-being'. Climatic conditions, feeble physique and the agricultural interests of the labourer are also suggested as other causes. With the reduction in the hours of work, improved sanitary conditions, ventilation in factories, and better supervision through the institution of the pass system, the loitering habit will be largely checked, and efficiency of labour enhanced. There is, for example, less loitering in the Calcutta jute mills, where labourers work in shifts for shorter hours, and in the engineering shops, where also the working day does not exceed eight hours.

§9. **Trying conditions of work in the mills.**—In the interests of the health and efficiency of the operatives, special attention is necessary to such matters as ventilation, the regulation of humidification in factories, arrangements for meals, bathing and latrine accommodation, etc. Conditions in all these respects are gradually getting better, but there is still ample scope for improvement. The problem of ventilation is one of light and free air in motion and presents special difficulties in cotton mills, which in large cities like Bombay are built in blocks of several storeys, where roof light is not possible except on the top floor. 'Experiments that have been made show a fall in efficiency during the hot weather in an ill-ventilated weaving shed as reaching twenty per cent.' Humidification presents another difficult problem. India does not possess the advantage of a naturally humid climate which is required for the spinning and weaving of cotton. To avoid breakage of thread and loss of material, artificial humidification of factories is therefore necessary. Such humidification, especially when effected by letting in steam and the use of impure water, is injurious to the health of the operatives. The Government of India has appointed an expert adviser on humidification to ensure the adoption of the best possible methods.

In most mills and factories in India, there are no proper arrangements for the meals of the operatives. A very small number of mills, such as the Buckingham and Carnatic Mills in Madras, have supplied dining sheds for the different caste people employed by them. There is an urgent need for suitable canteens which can be patronized by workers of both sexes. Supply of pure drinking water, arrangements for bathing, so essential in a hot country, and sanitary latrine accommodation are further points in regard to the conditions in factories to which the employers of labour have not yet learnt to attach sufficient importance as increasing the comfort of the worker and improving his efficiency.

§10. **Absenteeism in Indian factories.**—The large percentage of absenteeism among operatives in India makes the smooth working of a factory extraordinarily

difficult. The millowners assert that there is an increase in absenteeism after increase of wages or payment of wages and bonus, and that the worker is satisfied when he has earned enough to keep body and soul together. The percentage of absenteeism (which in the case of Bombay varies on an average from eight to twelve per cent) shows seasonal variations, reaching its maximum in the monsoon months and the festival and marriage seasons, being thus highest from March to June and lowest in December and January. In Calcutta there is a large annual exodus in the hot season because the jute industry season is slack after the winter and because the climate in the early part of summer is particularly trying.

Absenteeism on this scale necessitates the maintenance of an excessively large muster roll and leads to the employment of inferior substitutes casually recruited, and therefore to inferior work. It is, however, not easy to suggest remedies. Attendance allowances have been tried with some success. The Textile Tariff Board suggests the formation of labour reserves which would make a casual *badliwala* unnecessary and also facilitate the grant of leave (*Report*, par. 60).

The rapid turnover of labour in factories is another drawback, and is closely connected with absenteeism.[1] The personnel of the workers in mills in industrial centres like Bombay, Madras and Nagpur may change almost completely in about a year and a half on an average. There is thus a needless increase in the costs of production and the efficiency of the workers suffers.

§11. **Efficiency of industrial labour.**—The position as regards the alleged inefficiency of Indian labour needs to be clearly stated. Indian labour is generally regarded as much less efficient than European labour. If by this we mean that the European labourer is capable of turning out much more work than the Indian labourer in a given time, it will not be possible to contradict such a statement. In his evidence before the Industrial Commission, Sir Alexander McRobert stated that the English worker was 3·5 or even four times as efficient as the Indian. Sir Clement Simpson calculated that 2·67 hands in an Indian cotton-spinning and weaving mill are equal to one hand in a Lancashire mill. Dr Gilbert Slater, however, points out that, in this calculation, the inferiority of the Indian worker is overstated. The difference in the number of weavers employed to attend one loom in India and England does not by itself provide an accurate measure of the difference in efficiency between Indian and English labour. In India, a larger number of workmen are employed because the value of the additional output is greater than the increase in the wage bill. In England, wages being much higher, economy in the number of workmen employed is imperative. Dr Slater however admits that though the inferiority of Indian labour is generally exaggerated, it is real enough, and indeed it need cause no surprise if we remember the much superior physique, greater intelligence, amenability to discipline and capacity for steady continuous toil of the English labourer. It is, however, necessary to accept with caution pseudo-mathematical statements such as those alluded to above. The

[1] Dissatisfaction with hours of work or wages leads to changes from one mill to another and the absence of standardization of wages intensifies the motive to change (R. K. Das, *Factory Labour in India*, pp. 44-5). The activities of the jobber going from mill to mill in search of labour are also held to be partly responsible for the evil, which Government employment bureaux may mitigate to some extent.

smaller outturn in an Indian mill cannot be wholly put down to the inferiority of the Indian operative, for his lower productivity may partly be the result of relatively inefficient management. Moreover, owing to the inferior quality of the cotton, there is continuous breakage in thread and more men have thus to be employed. It is also complained that, unlike the Lancashire millowners, the millowners in India do not use the most up-to-date labour-saving devices and machinery. One reason for this is that all machinery has to be imported from abroad, which makes it much more expensive than in England, and as wages are lower in India, this often determines the balance in favour of employing more hands rather than investing in the most up-to-date machinery and the latest labour-saving appliances.

The Industrial Commission thought that Indian labour does not produce as cheaply as Western labour in spite of its lower wages. Dr Nair argued in 1908 that 'if one Lancashire operative is equal to 2·67 Madras operatives, then, since the average monthly wage of a Lancashire operative is about Rs. 60 (£4), while that of a Madras operative is only Rs. 15 (£1), it is clear that for the same money the Indian millowner gets nearly double the work that an English millowner does'.[1] This amounts to saying that Indian labour is actually more efficient than Western labour. However, the relative inferiority of Indian labour is now almost universally admitted.[2]

§12. **Causes of the inefficiency of Indian labour.**—Some of the causes of inefficiency are permanent while others are temporary or remediable. To the former class belong the climatic conditions in India which are generally adverse to high labour efficiency. Thinking of the cotton industry we may note that Lancashire possesses a great advantage in its cold and invigorating climate, denied to most parts of India where the industry is located. Again the artificial humidification which is necessary in India is at best a poor substitute for the naturally moist climate of Lancashire and is liable to inflict serious injury on the health of the operatives unless it is properly regulated. The causes susceptible to remedy, such as the unsatisfactory conditions as regards ventilation and sanitation, etc., have already been referred to. Further, it may be urged that the hours of work are still much too long, especially for a tropical country, and there is probably much truth in the suggestion that the slackness and listlessness of the Indian worker are a kind of protective device which he unconsciously adopts to prevent the constitutional breakdown which strenuous labour for long hours would otherwise inevitably bring about.

It is undoubtedly a fact that the physique of the average Indian worker is inferior to that of an average English worker. This is due especially to two causes,

[1] Pillai, op. cit., p. 224.

[2] Mr (now H. E. Sir) H. P. Mody, Chairman of the Bombay Millowner's Association, in his oral evidence before the Labour Commission, gave the following figures relating to comparative labour efficiency: 'In Japan a weaver minds six looms and efficiency there is 95 per cent. In China a weaver minds four looms and efficiency is 80 per cent. In Bombay a weaver minds two looms and efficiency is 80 per cent. Calculated on the basis of Japan and China a weaver in Bombay is paid between 200 and 300 per cent more than a weaver in Japan or China.'

(i) the ravages of disease, and (ii) a poor dietary. While, as we have seen, the rural areas are by no means free from the ravages of major diseases like malaria, plague, cholera, influenza, kala-azar, hook-worm, etc., their incidence is especially heavy in congested industrial areas. The terrible slums where labourers have to reside are first-rate breeders of pestilence and provide almost ideal conditions for its rapid spread.

An organization for the improvement of public health, which would include the supply of pure water, unadulterated food, and a proper drainage system, is absolutely necessary along with better medical facilities and a system of insurance against sickness of industrial workers.

As regards the effects of a poor dietary, this is a question which concerns the whole Indian population and will be discussed in Chapter IV.

§13. **Conditions of housing.**—The unbelievable overcrowding and appalling conditions of sanitation in most of our industrial towns largely account for the instability and low efficiency of labour in the towns. In some of the industrial areas in India where factories have been established at some distance from the towns, the problem of housing and sanitation is comparatively simple. The labourers are often housed in the neighbouring villages or in dwellings that take the form of single-storey 'lines' erected by the employer, who can acquire the necessary land without much difficulty. The second stage of development and congestion is typified by such cities as Madras, Cawnpore, Nagpur, Ahmedabad, and in a very large proportion of industrial areas round Calcutta. In these areas land is far cheaper than in Bombay and Calcutta proper, and accommodation usually consists of single-storey huts in groups known as *bastis*, erected by persons other than the owners of mills and rented to mill-hands on fairly reasonable terms. In some cases, as at Cawnpore, Calcutta and Ahmedabad, the more enlightened factory owners have found it advisable to supply housing accommodation to the employees in the hope of commanding the pick of the labour market, especially in the case of such a fluid labour force as that on which the textile factories rely.[1] The condition of housing in Ahmedabad appears to be worse than in any other industrial centre in India. In practically every industrial centre the evil of overcrowding has been allowed to grow, no control having been exercised over the selection of sites for industrial development. This has naturally led to a shocking state of affairs. 'The majority of the working classes are housed in *chawls* or tenements which consist usually of single rooms, sometimes of double rooms or *gallas*, but never of more than two rooms. These *chawls* have for their object the housing—one is almost tempted to use the expression 'warehousing'—of large numbers of the labouring classes in as cheap a manner as possible.'[2]

The vast majority of the working-class families in Bombay (more than 70 per cent) live in single rooms. The average number of persons per room in the case

[1] Workmen are generally somewhat reluctant to avail themselves of housing facilities provided by employers as this directly or indirectly involves a restraint on their liberty. For example, they are liable to be penalized, in case of strike or lock-out, by being turned out summarily. They may also be spied upon for activities which the employers may regard as unwholesome. (See B. Shiva Rao, *The Industrial Worker in India*, p. 105).

[2] Hurst, op. cit., p. 20. See also *Industrial Commission Report*, par. 241.

of working-class quarters is 4·03. These figures stand in striking contrast to those of London, where only 6 per cent of the total population live in one-room tenements with an average of 1·92 persons per room. The practice of sub-letting is common among industrial workers in Bombay, which causes further overcrowding. Although the *chawl* is a special abomination of Bombay, the evil of congestion and over-crowding is by no means unparalleled in other centres. The overcrowding in certain parts of Howrah, for instance, is probably unequalled in any other industrial centre in India. Even smaller industrial towns are showing the same tendency.

§14. **Adverse effects of bad housing and sanitation.**—'Good houses mean the possibility of home life, happiness and health; bad houses spell squalor, drink, diseases, immorality, crime, and in the end demand hospitals, prisons and asylums in which we seek to hide away the human derelicts of society that are largely the results of society's own neglect.' Insufficient and bad housing is also one of the factors responsible for industrial unrest. All these evils are present in varying degrees in Bombay. One of the greatest evils is the heavy infant mortality in the Bombay slum areas. The rate of mortality varies inversely with the number of rooms in the dwelling-place. For instance, in 1936 the percentage of deaths of infants in one-roomed tenements was 78·3.[1] The highest rate reached in the worst localities is 298 per 1,000 registered births as against the average rate of 200 to 250 for the general population.[2] Lastly the appalling conditions of *chawl* life and the absence of privacy also have a deterrent effect on those who wish to bring their families with them to the towns and have thus a very unsettling effect on the stability and efficiency of labour. The Labour Investigation Committee came to the conclusion that, like education and medical relief, industrial housing must be accepted as a Government responsibility.

§15. **Attempts at improved housing.**—In Bombay, while water-supply, sanitation and drainage were improved, no heed was given for a long time to the removal of congestion and the destruction of the slums, so that the position became worse and worse every year. The heavy mortality and the great exodus from Bombay that followed in the wake of the great plague of 1896 and the consequent paralysis of trade and industry brought matters to a head, and the Bombay Improvement Trust was established in 1898 to make new streets, open out crowded areas, reclaim land from the sea to provide room for expansion, and construct sanitary dwellings for the poor. The limited powers and funds of the Trust, and want of proper co-operation between the Trust and the Corporation, and its inevitable unpopularity brought on by its compulsory acquisition of private property and demolition of buildings, prevented rapid progress and led to the adoption of the policy of 'slum-patching'. Nevertheless the Trust did some highly useful work.

The Municipality also had by 1920 provided 2,900 tenements for its staff and had sanctioned the construction of another 2,200. The Port Trust had provided quarters for nearly 5,000 of its employees. In the meantime, the population of the city was increasing rapidly and the millowners did little in the matter of housing their operatives. By way of preventing further congestion and securing better housing, the Industrial Commission recommended refusal of permission, with a

[1] *Report of the Rent Enquiry Committee* (Bombay), 1939, par. 26.

[2] *L.C.R.*, 271.

few exceptions, to establish fresh industrial concerns;[1] the setting up of a special area for industrial development; the removal of the existing railway workshops to a reasonable distance from the city; supply of housing accommodation to their employees by railways, Government Departments and public bodies; improved communications with the object of creating industrial suburbs; a definite standard of accommodation for industrial dwellings located in the city; and a programme of construction worked out and taken up by Local Authorities. At the end of the 1914-18 war, a bold and comprehensive scheme of a Development Directorate to deal with the problem was drawn up by the Bombay Government. The funds were derived from the proceeds of a development loan of Rs. 9 crores and a 'town duty' of one rupee per bale of cotton on all cotton entering Bombay. However, a large number of the tenements built, especially the *chawls* at Worli, remained unoccupied for more than ten years. Their inability to attract the workers has been attributed to difficulties of access, absence of bazaar facilities, cement construction (which makes the room uncomfortably warm in hotweather and uncomfortably cold in cold weather), high level of rents, lack of lighting and lack of police protection. Some attempts have been made to correct these defects. The Municipality and the Port Trust are also carrying out their programmes of development, and the Port Trust has constructed a new cotton depot at Sewri. In May 1947, the Bombay Government started their new housing scheme at Worli under which tenements will be built to suit single workers as well as different sizes of workers' families. There will be no more one-room tenements in Bombay city. The difference between economic rent and realizable rent will be covered by subsidies, contributions and levies.

So far as the millowners are concerned, some mills, like the Jacob Sassoon Mill, have provided housing accommodation to their operatives. The difficulty of procuring land on moderate terms in the vicinity of the factories, the absence of any guarantee that the operatives housed by a mill will not accept work in other mills, and the reluctance of the operatives themselves to take advantage of such arrangements, have made progress inevitably slow. The operatives fear loss of liberty of action and probable ejectment in case of strike, and resent sanitary rules and discipline, the value of which they do not understand. More favourable conditions in these respects exist at Cawnpore, Nagpur, Ahmedabad and Madras, where the millowners have taken greater interest in the housing of their operatives, with considerable advantage to both parties. Special mention may be made of the magnificent scheme of industrial housing launched by the Empress Mills at Nagpur managed by Messrs. Tata Sons Ltd, and the housing scheme at Jamshedpur for the staff and employees of the Tata Iron and Steel Company Ltd. The main obstacles at present in improving housing conditions for industrial workers are scarcity of suitable building sites, high cost of building material and labour, and shortage of building material.

The Labour Commission made a variety of suggestions. They recommended that (i) the Land Acquisition Act should be amended so as to enable owners of industrial concerns to acquire land for the erection of workers' dwellings and

[1] This suggestion has been accepted and no new mills are allowed to be erected in the town of Bombay proper.

accordingly, on the initiative of the Government of India, the Act was amended in 1933; (ii) Provincial Governments should make a survey of urban and industrial areas to ascertain their needs with regard to housing and arrange for mutual consultations for devising practical plans of co-operation among all interested parties; (iii) the Government should lay down minimum standards in regard to cubic space, ventilation, lighting, water-supply, drainage, etc.; (iv) town-planning Acts should be passed wherever necessary; (v) the provision of working-class housing should be a statutory obligation on every Improvement Trust; (vi) co-operative building societies should be encouraged; (vii) municipalities should revise, bring up to date and enforce rigorously by-laws dealing with health, housing and sanitation (*L.C.R.*, ch. xv).[1]

The Cawnpore Labour Enquiry Committee in their Report (pars. 211-12) recommended that the Provincial Government should float a loan of Rs. 50 lakhs and place a sum of Rs. 10 lakhs every year for five years at the disposal of the Improvement Trust for constructing about 12,000 houses for workmen. The Rent Enquiry Committee appointed by the Government of Bombay in 1938 recommended a ten-year housing programme for the supply of cheap and small tenements through the agency of the Municipality, assisted by the State. The Committee also recommended that employers of 10,000 persons and more should be required to bear the responsibility of housing at least 25 per cent of their employees.[2] The problem of industrial housing bristles with difficulties connected with finance, management, design, etc., not the least of which arises from the total indifference of the workers themselves to the necessity of clean and sanitary housing. Proper education of the workmen in elementary hygiene, and as far as possible the approximation of industrial dwellings to conditions obtaining in the villages, ought to help in ensuring clean and suitable dwellings and securing the stability of industrial labour.

§16. **Wage rates.**[3]—The Labour Office of the Government of Bombay conducted four inquiries into the wages of workers in the cotton mills in the Bombay province in 1921, 1923, 1926 and 1934.[4] The Government of Bombay in 1934 launched a comprehensive General Wage Census, according to which the average daily earnings of all the adult operatives in all occupations in the cotton textile industry in the Bombay province in 1934 were as follows: Re. 1-1-10 in Bombay city; Re. 1-5-7 in Ahmedabad city; Re. 0-15-7 in Poona; and Re. 0-11-8 in Sholapur city.[5]

The average monthly earnings for men in all engineering and 'common' occupations excluding unskilled labourers (all factories) according to the Wage

[1] One of the obstacles to housing reform through the agency of municipalities is that they are too often dominated by slum-owners.

[2] *Report of the Rent Enquiry Committee* (Bombay), 1939, pars. 85-7.

[3] The wage rates mentioned in this section are pre-war rates (before 1939). Dearness allowances are now granted to counteract the increase in the cost of living due to the war and an attempt is made to relate them to changes in the cost of living. The actual methods, however, of fixing these allowances vary from centre to centre.

[4] *Wages and Unemployment in the Bombay Textile Industry* (1934).

[5] *Labour Gazette* (Bombay), July 1937, p. 681.

Census taken in Bombay were as follows: Rs. 41-8-5 in Bombay city; Rs. 33-7-4 in Ahmedabad city; Rs. 29-1-7 in Poona; and Rs. 22-1-4 in Sholapur city. The average for the province was Rs. 38-3-3.[1]

In the jute industry in Bengal the average monthly wages of the different classes of employees vary from Rs. 40, for example metal turners (we exclude Chinese carpenters, who earn as much as Rs. 93 per month), to Rs. 11, for example bobbin cleaners. Wages are appreciably higher in the case of workers in the single-shift system than in that of workers in the multiple-shift system.

The daily earnings of underground workers in the more important coal-fields in 'British' India varied according to locality from Re. 1-7-0 to about 13 annas for foremen, *sirdars*, etc., from 14 to 8 annas for miners and from 12 to 6 annas for loaders. In the case of other underground workers the rate of wages depended on whether they were skilled or unskilled.

The general scale of wages was lower for workers engaged on 'open workings' and lowest for labourers working on the surface. On the tea plantations in Assam the family has to be taken as the working unit and the monthly cash earnings of an average family varied considerably according to districts, being apparently highest (about Rs. 32) in Dibrugarh District and lowest (about Rs. 15) in the Cachar, Sadr and Hailakandi Districts. During the last few years, there has been almost a revolutionary change in the industrial wage structure. Government were anxious to see that industrial unrest did not prejudice the tempo of production during the progress of the recent war. The awards of adjudicators and Industrial Tribunals and Industrial Courts set up by Government have resulted in substantial improvement in the wage structure of industrial labour; although in many cases the increase in the level of wages has not kept pace with the rise in prices.

§17. **Low standard of living.**—The low standard of living of the Indian labourer may be regarded as a further cause of inefficiency. It is both the cause and the effect of the low wages. In conformity with Engel's Law, we find that the average income of the worker in India being very small, a very high percentage of it is spent on food and that the percentage decreases with the increase in the size of the income. In Bombay, for example, the Report on the inquiry into working-class budgets in 1921-2 showed that the expenditure on food varied from 60·5 per cent in the case of incomes below Rs. 30 per month to 52·6 per cent in the case of incomes between Rs. 80 and Rs. 90 per month. In countries with a high standard of living, like England and the United States, a comparatively much smaller proportion of the wage-earner's income is absorbed by food and the other elementary necessities of life and more is left over for conventional necessaries and luxuries. The standard of living of the Indian worker falls far short of what is required for full efficiency.

The Report on the last inquiry into the working-class budgets in Bombay city conducted by the Labour Office in 1932-3 showed that the average monthly expenditure of the family was Rs. 45-15-9. Except in the income groups 'below Rs. 30' and 'Rs. 30 to Rs. 40', the income was in excess of the expenditure, and in the income group 'Rs. 90 and over' the surplus left at the end of the month was about 22·5 per cent of the monthly income. This was the position at the time of

[1] *Report on the General Wage Census* (Bombay), Engineering Industry, Part I, p. 97.

the inquiry, and prior to the wage-cuts which were effected subsequently, especially in the cotton mill industry.

The average monthly income of a working-class family[1] was seen by the above inquiry to be Rs. 50-1-7 in Bombay, Rs. 46-5-0 in Ahmedabad, Rs. 39-14-10 in Sholapur, and Rs. 37-5-11 in Madras. With incomes of this order it is clearly impossible to maintain any satisfactory standard of living. The worker cannot afford sufficient wholesome food, even supposing he utilizes his income with the most complete wisdom. We have already described his sorry plight as regards shelter. His clothing is too scanty even for a warm climate. The expenditure on education is almost nil. The only furniture he can afford is limited to a few rough dealwood boxes, iron plate trunks, bamboo sticks, a country blanket, a worn-out mat, a few knick-knacks and cheap chromolithographs representing scenes from mythology.[2] Most workers have to spend a considerable proportion of their incomes on travelling to and from their villages. Another large part goes to meet the interest on the debts they have almost invariably incurred.[3] The usual rate of interest charged is one anna per rupee per mensem, or seventy-five per cent per annum, and compound interest is charged if the interest is not paid regularly. Interest on debts represents an average expenditure of nearly three per cent of the total monthly expenditure.[4]

§18. **Expenditure on drink.**—The evil of drink is spreading in an alarming fashion among the factory labourers, and it is believed that at least four per cent of the total expenditure of the working classes, as shown by family budgets, goes on drink, the percentage being as high as ten in the case of the lowest class of workers like scavengers. The male worker (women rarely drink) frequently tries to relieve by drink 'the hard and long day's work in the mill under the scorching humid heat of an eastern sun' (Hurst). There is a physiological connexion between craving for drink on the one hand and unwholesome conditions of work and malnutrition due to poverty on the other. If the money spent on drink were to be used for buying more and better food, there would, of course, be less malnutrition. The worker is thus not only extremely poor, but is also unable to manage his expenditure in the best possible manner, and the expenditure on drink serves to aggravate his poverty which in its turn leads to an increase of drunkenness. Among remedies being tried are the substitution of tea shops, cinemas, clubs and other forms of recreation for the tavern, and the curtailment of the number of liquor shops and the hours of opening, along with rationing in mill areas. In this connexion reference may be made to the policy of prohibition adopted by the Congress Ministries in Bombay, Madras and other provinces. The Government of Bombay introduced total prohibition in the industrial cities of Ahmedabad (1938) and Bombay (1939). The successful challenge in the law courts of the legal basis of prohibition, however, led to a certain measure of relaxation of prohibition. The ban on sales of

[1] The average size of the family was 3·70 persons in Bombay, 4·05 in Ahmedabad, 4·57 in Sholapur, 4·33 in Nagpur, 3·76 in Jubbulpore and 6·03 in Madras.

[2] Hurst, op. cit., p. 63.

[3] According to the inquiry in 1923 into the working-class budgets in Bombay by the Labour Office, forty-seven per cent of the families were in debt and the debt was the equivalent of two and a half months' earnings (one month's average earnings per family being Rs. 52-4-6).

[4] See also §21.

foreign liquor was withdrawn with effect from 2 July 1940 and that on country liquor was modified. The Congress Ministries, however, are pledged to the policy of prohibition and a number of the State Governments have embarked upon this policy irrespective of the heavy financial sacrifice involved and irrespective of directives from the Central Government to proceed more slowly and deliberately.

§19. **Case for higher wages.**—Employers are often found urging that increase in wages is either dissipated in drink or leads to greater idleness on the part of the labourer, instead of raising his standard of living, and that consequently there is no improvement in his efficiency. Professor Pigou effectively disposes of this objection to higher wages as follows:

'It is true that at any given moment the taste and temperament of persons who have long been poor are more or less adjusted to their environment and that a sudden and sharp rise of income is likely to be followed by a good deal of foolish expenditure, which involves little or no addition to economic welfare. If, however, the higher income is maintained for any length of time, this phase will pass, whereas, if the increase is gradual, . . . the period of foolishness need not occur at all. In any case, to contend that the folly of poor persons is so great that the rise of income among them would not promote economic welfare in any degree, is to press paradox beyond the point up to which discussion can reasonably be called upon to follow.'[1]

Another standard objection to raising the rate of wages is that the effect is likely to be very soon cancelled by an increase in population. This point has already been dealt with (see vol. I, ch. iii) and we have advanced the view that increase of wealth, although it may express itself partly in increase of numbers, may also be expected partly to result in raising the standard of living. The standard of living of industrial labour in India, low as it is, shows signs of rising steadily.

The conditions of international competition are also alleged to be a formidable obstacle to the levelling up of wages. The fact that a country may gain a substantial advantage, at least temporarily, over another by sweating its workers may be admitted. At the same time, it does not follow that other countries also must in self-defence adopt similar methodsof sweating. It is arguable that sweated trades do not pay in the long run as they lead to diminished efficiency. In any case, no civilized community can afford to forget that, equally important with the economic ideal of increase of production, is the moral ideal of increase in the quality of human life. The proper method of equalizing conditions of international competition is to get every nation to agree to secure certain minimum conditions of working. But even when a particular nation remains recalcitrant, protection against it must be sought in other ways than by imposing or acquiescing in a dangerously low standard of living for the workers.

§20. **Legal minimum wage.**[2]—The Eleventh International Labour Conference held at Geneva in 1928 adopted a draft convention providing for the creation and maintenance of machinery whereby minimum scales of wages can be fixed for workers employed in certain of the trades and in particular in home industries, in

[1] A. C. Pigou, *Economics of Welfare*, pp. 53-4.

[2] See *Indian Journal of Economics*, Conference Number, 1940. Papers on Minimum Wage Legislation and its Applicabilty to India by B. R. Seth and S. P. Saksena respectively.

which no arrangements exist for the effective regulation of wages by collective agreement or otherwise, and in which wages are exceptionally low. The Labour Commission suggest that before minimum wage-fixing machinery can be set up, industries in which there is a strong presumption that the conditions warrant detailed investigation should be selected and a survey of the conditions in each such industry should be undertaken as the basis on which it should be decided whether the fixing of a minimum wage is desirable and practicable. When a decision has been reached as to whether the conditions in any case justify the setting up of machinery, particular attention should be given to the cost of enforcement, which may be prohibitive owing to the slow growth of the spirit of compliance with law among employers, the ignorance and illiteracy of the workers, the possibility of collusion, etc. The policy of gradualness should not be lost sight of if the desired end is to be achieved without disaster.[1]

The Cawnpore Labour Enquiry Committee accepted the principle of a basic minimum wage, and recommended that no worker should get a wage of less than Rs. 15 per month of 26 working days. The Labour Enquiry Committee's figure would now (1950) have to be multiplied by at least three. They also recommended the establishment of a Wage Fixation Board to function on the lines of the British Trade Boards for the adjustment of wages from time to time on the basis of the minimum cost of living.[2] The Bihar Labour Inquiry Committee, appointed in 1938, reported in June 1940 and made over 150 recommendations for improving the conditions of labour in that province. The 1947 Report of the Central Pay Commission has recommended a new pay structure for government servants from the highest to the lowest. It proposes that the maximum salary should not be more than Rs. 2,000 per month and that the lowest salary should not be less than Rs. 30 per month. The recommendations of this Commission have greatly influenced, directly or indirectly, the policy of wage fixation throughout the country.

§21. **Indebtedness.**—The majority of the industrial workers in India remain in debt for the greater part of their working lives. It is estimated that in most industrial centres not less than two-thirds of the labouring population is in debt and that the amount of debt commonly exceeds three months' wages. Most of the workers are in debt to their food suppliers. Defaults are common and are in fact encouraged by the moneylender, so that a small initial loan speedily accumulates into a permanent and intolerable burden. The most important single cause of indebtedness is the expenditure on festivals, especially marriages. The worker would benefit if his attractiveness as a field of investment were reduced and if it were made unprofitable for the moneylender to advance amounts which it is beyond the capacity of the worker to repay. The Labour Commission proposed that the salary and wages of all workmen receiving less than Rs. 300 per month should be exempted from attachment, as also workers' contributions to bonafide provident funds. The Government of India have accordingly amended the Civil Procedure Code with a view to exempting from attachment salaries below a defined limit. It is also suggested that arrest and imprisonment should be abolished in the case of

[1] *L.C.R.*, 212-14.

[2] *Report of the Cawnpore Labour Enquiry Committee* (1938), pars. 85 and 98.

an ordinary industrial worker unless he is proved to be able and yet unwilling to pay and that summary procedure should be instituted for the liquidation of workers' unsecured debts and the Courts empowered to adjust the amount of the decree to what the worker could pay without undue hardship. For the protection of indebted workers, the Cawnpore Labour Enquiry Committee commended a measure on the lines of the Central Provinces Protection of Debtors Act, 1937.[1] This Act makes molestation of a debtor a cognizable offence. There is a more restricted Act in force in Bengal. Provision of co-operative credit appears to offer a more lasting solution of this problem.[2]

Labour Legislation in India

§22. **Growing scope of labour legislation in India.**—Labour legislation in India does not occupy the same important position as in fully industrialized countries like England, owing to 'the deliberateness of the spread of mechanical power and narrowness of the area affected'. Much of the work is done out of doors or in sheds without walls, and the problems of overcrowding, bad ventilation and undesirable mixing together of the two sexes have not to be faced on the same scale. With the growing industrialization of the country, a better realization of the duties of the State towards labour, the recent awakening of the working classes in India to their rights and the acceptance by India of her obligations towards the International Labour Organization of the League of Nations (at first, and now towards U.N.O.), labour legislation is coming to occupy a more and more important position.[3] Determined State action for the purpose of minimizing the well-known evils of industrialism is necessary even if it means a certain slackening of the pace of industrialization. So far we have on the whole failed to profit by the experience of European countries. Without the excuse of ignorance we have allowed to appear in our midst certain familiar abuses, such as the rise of slum-cities, the exploitation of child-labour, excessively long hours of work for men and women, bad sanitation and absence of safety measures—abuses which we are now trying painfully to correct.

§23. **Need for uniformity of labour legislation.**—The inauguration of provincial autonomy under the Government of India Act (1935) and the advent of popular Ministries resulted in much legislative activity which aimed at progressive improvement in the position of labour. However, it also brought into prominence the lack of uniformity in the labour policies of the several Provincial Governments. Such disparity is bound to affect adversely the industrial development of the country, especially in the more advanced provinces. This question was considered at the first conference of Labour Ministers and the State Administrations held in 1940. The conference decided that the Central Government should draft legislation on four important subjects (industrial disputes, holidays with pay, collection of industrial and labour statistics, and an amendment of the Payment of Wages Act), for consideration by the provinces and by the next conference of Labour Ministers.

§24. **Beginnings of factory legislation in India.**—The progress made by the Bombay cotton mill industry aroused the jealousy of the Lancashire manufactur-

[1] *Report*, p. 237. [2] See Vol. 1, ch. x, §11. [3] See §1.

ers. The agitation they set up—apparently for the benefit of labour in India but actually to place difficulties in the way of Indian industrialists—resulted in the appointment of a Factory Commission by the Government of Bombay in 1875, of which the first Factory Act (1881) was the outcome. Its main provisions were as follows:

The employment of children below the age of seven was prohibited. Between that age and twelve, they were not to work for more than nine hours a day. An hour's daily rest and four holidays in the month were prescribed for children. No relief, however, was given to women and adult male labour. The Act applied to factories employing not less than a hundred persons and using power. Local Governments were to appoint Inspectors of Factories.

Agitation to amend the first Factory Act began almost immediately after its passing. Again pressure from Lancashire resulted in the Secretary of State moving in favour of the expeditious adoption of more rigorous legislation, and the second Factory Act of 1891 was passed. Its provisions applied to all establishments using power and employing not less than fifty persons. But the local Governments were to have power to extend it to others employing not less than twenty persons. The lower and upper age-limits for children were raised to nine and fourteen respectively, their hours of work were limited to seven in any one day and had to be between the hours of 5 a.m. and 8 p.m. Women were not to work in factories before 5 a.m. and after 8 p.m., except in places where an approved system of shifts existed. Their hours of work were limited to eleven in one day entitling them to a total rest of one and a half hours. Men workers were to enjoy an interval of half an hour's rest between 12 noon and 2 p.m. and a weekly day of rest. There were also certain provisions which secured better ventilation and cleanliness and aimed at preventing overcrowding in factories.

§25. **Factory Act of 1911.**—Excessive hours of work in Bombay mills made possible by the increasing use of electric light, and also in some Calcutta jute mills, the usual agitation on the part of Lancashire manufacturers, the agitation by the press in India and the lead given by some employers of labour led to the appointment of a commission which reported in 1908.[1] This was followed by the passing of the Factory Act of 1911 which brought within its scope seasonal factories working for less than four months in the year. It made the possession of an age certificate compulsory and reduced the hours of work for children in textile factories to six per day. The Act restricted the employment of women by night, allowing it only in cotton ginning and pressing factories. For the first time the hours of adult male workers were restricted by law, the limit being twelve hours per day in the case of textile factories. In all textile factories, except those working with an approved system of shifts, no person was to be employed before 5 a.m. or after 7 p.m.—the new limits laid down generally for the employment of women and children. Lastly, more extensive provisions relating to health and safety were introduced and factory inspection was made more effective.

§26. **Factories Act of 1922.**—The war of 1914-18 had important effects on factory administration and ultimately on the Factory Act. There was a considerable

[1] A. G. Clow, *Indian Factory Legislation*, pp. 39-45.

extension of industrial activity in India and the number of factories and of persons employed rose by about twenty-five per cent between 1914 and 1919. Factories had to be exempted from many provisions of the Factory Act and there was a fall in the average number of inspections. But the most important effect was produced on the workers. The increased demand for labour strengthened their position, while the rising prices and profits and the general unrest which followed the war led to increased consciousness of power and a strong disinclination to accept disagreeable conditions. Thus for the first time in India the desire of the operatives became a potent force in securing improved conditions and more drastic legislation.

The acceptance by India of her obligations, arising from the conventions adopted by the International Labour Conference at Washington in 1919, necessitated further changes in factory legislation. By the Factories Act of 1922, all power-using factories employing not less than twenty persons became subject to factory legislation. Option was given to the local Governments to extend it to factories employing not less than ten persons whether power was used or not. The minimum age of employment for children was raised to twelve and the upper limit to fifteen. Children between these ages were not to work for more than six hours a day in any factory. Children and women were not to be employed in any factory before 5.30 a.m. or after 7 p.m. The hours of work for adults were limited to sixty in a week and eleven in any day, a week consisting of not more than six days. Liberal rest intervals were also secured to all classes of workers. The Act provided for a rest period of an hour after every six hours, though this might be split up into two half-hours at the request of the employees, provided not more than five hours' continuous work was done. The system of inspection was further improved by the appointment of more whole-time inspectors with good technical qualifications, in the principal industrial centres. Lastly, provisions regarding safety and health were further extended, the local Governments being given power to fix standards of ventilation and artificial humidification.

§27. **Factories Act of 1934, Factories Amendment Act of 1946 and Factories Act, 1948.**—The Factories Act of 1922 was amended in 1923, 1926 and 1931. Certain administrative difficulties were thus removed and a few improvements of a minor character were introduced. A new consolidating Act was passed in 1934 on the recommendation of the Labour Commission and brought into force from 1 January 1935. This Act

(i) Draws a distinction between seasonal and perennial factories.

(ii) Introduces a third group of adolescents (over fifteen and under seventeen years of age, deemed to be children if not certified as fit for adult employment).

(iii) The existing maximum limits of eleven hours per day and sixty hours per week continue to apply in the case of seasonal factories but are reduced to ten and fifty-four respectively in the case of perennial factories subject to certain exceptions. For children the maximum hours everywhere are five per day.

(iv) The principle of 'spreadover' is introduced for the first time, that is, the period of the number of *consecutive* hours of work is limited to thirteen in the case of adults and seven and a half in the case of children.

(v) The existing provisions with regard to control of artificial humidification are expanded. The Act also gives power to local Governments to authorize an in-

spector to call upon managers of factories to carry out specific measures for increasing the cooling power of the air where necessary.

(vi) Certain provisions are made with regard to welfare, such as adequate shelters for rest in factories, rooms reserved for the use of children of female workers, first-aid appliances, etc.

(vii) Power is given to local Governments to make rules prescribing fitness and preventing the employment of children not certified as fit.

(viii) Inspectors are authorized to require managers to remedy any inadequacy or defect in the construction of a factory likely to be dangerous to workers.

(ix) Limits are imposed on the amount of overtime that can be worked and payment for overtime is regulated. The Factories Amendment Act lays down a 48-hour week in all perennial factories in 'British' India. Provincial Governments are, however, empowered to extend this limit, if necessary, in the interest of the public.

The Factories Act, 1948, which came into operation from 1 April 1949, covers all power-using industrial establishments employing 10 or more workers, and establishments employing 20 or more workers and not using power. The State Governments have been empowered to apply the provisions of the Act to any premises irrespective of the number of persons employed, where a manufacturing process is carried on with or without aid of power except where the work is done by the worker solely with the aid of his family. The distinction between seasonal and perennial factories no longer exists.

The State Governments have been empowered to make rules requiring the registration and licensing of factories. The Act lays down that the occupier of a factory shall before occupation send to the Chief Inspector of Factories a written notice containing full details regarding the factory.

The Act prescribes certain provisions regarding sanitation, temperature, ventilation, prevention of overcrowding, provision of amenities; provisions regarding safety, precautionary measures against fire, dangerous fumes, explosive or inflammable dust, etc.

The maximum hours of work per week and per day have been fixed at 48 and 9 respectively. The maximum spreadover permitted is 10½ hours. No worker shall work more than 5 hours before he has had a rest interval of at least half an hour. Payment for overtime is to be double the ordinary payment. The hours of employment for women are to be between 6 a.m. and 7 p.m. and there is to be a weekly day of rest.

Children below 14 are not to be employed. Children, i.e. workers between 14 and 18, shall not be allowed to work without a certificate of physical fitness from a certifying surgeon. They are not to work for more than 4½ hours per day and not to work between 7 p.m. and 6 a.m.

§28. **The Bombay Shops and Commercial Establishments Act (1939).**—This new piece of labour legislation initiated by the Congress Ministry of Bombay, which has thus given a lead to other provinces, is intended to make provision for the regulation of hours of work in shops, commercial establishments, restaurants, theatres and other establishments. The Act tries to check the old abuses of long

hours, ranging from 11 to 15 a day, and totally inadequate provision for holidays and rest intervals, without at the same time overlooking the requirements of commerce and the consumer. So far as shops are concerned the maximum hours of work are fixed at 9½ per day; half an hour's rest after five hours of work is prescribed, and a weekly holiday is made compulsory. Similar legislation was enacted and brought into force during the year 1941 in three other provinces—Bengal, the Punjab and Sind.

§29. **The Tea Districts Emigrant Labour Act (1932).**—Plantation is closely allied to industrial labour, but raises special problems of its own, in particular in the methods of recruitment, especially for the tea gardens in Assam. Recruitment and other matters relating to plantation labour are at present governed by the Tea Districts Emigrant Labour Act. This Act, passed in 1932 and based on the recommendations of the Labour Commission, extends to the whole of 'British' India including the Santhal Parganas and repeals the Assam Labour and Emigration Act, 1901, and the subsequent amending Acts. The Act of 1901 was intended to regulate the system of indentured labour for tea plantations in that province introduced in the thirties of last century. The Amending Act of 1915 abolished the system of recruitment by licensed contractors which was introduced by the former Act. Thereafter recruitment could only take place through the agents of the official Labour Board. The first object of the Act of 1932 is to make it possible, on the one hand, to exercise all the control over the recruitment and forwarding of assisted emigrants to the Assam tea gardens that may be justified and required by the interests of emigrants and potential emigrants; and, on the other hand, to ensure that no restrictions are imposed which are not justified. Local Governments are empowered, subject to the control of the Government of India, to impose control over the forwarding of assisted emigrants or over both their recruitment and their forwarding as occasion may dictate. Employers are prevented from recruiting otherwise than by means of certificated garden *sirdars* or licensed recruiters. It is made unlawful to assist persons under the age of sixteen to emigrate unless they are accompanied by their parents or guardians. With regard to the question of repatriation, every emigrant labourer, on the expiry of a period of three years from the date of his entry into Assam, has the right of repatriation as against the employer employing him at such expiry. It is also possible to claim repatriation within three years in the event of the emigrant failing in health, not being provided with suitable work, or having his wages unjustly withheld or for any other sufficient cause.

Provision is made for the appointment of a Controller of Emigrants with some staff and possibly one or more Deputy Controllers for supervising the general administration of the system which the Act seeks to establish. The charges are met from an annual cess called the Emigrant Labour Cess which is levied at such rate not exceeding Rs. 9 per emigrant as the Governor-General-in-Council may, by a notification in the *Gazette of India*, determine for each year of levy.

§30. **Labour legislation for mines.**—Labour regulation was much tardier in coming in the case of the mining than in the textile industries. In 1901, the first Indian Mines Act was passed and inspectors were appointed. In view of the recommendations of the Washington Conference and the large numbers employed in the rapidly developing mining industry, revised legislation was passed in 1923.

It enlarged the definition of a mine, limited the hours of work to sixty per week for workers above ground, and fifty-four for workers underground. A week was not to consist of more than six days. No child was allowed to work below ground and a child was defined as a person under the age of thirteen years. No restriction was placed on the employment of women underground. In view of the fact that forty-five per cent of the labour employed below ground was composed of women, sudden and absolute prohibition would have caused serious dislocation in one of the basic industries of the country. On the other hand, the need for reform was equally clear. In exercise of the power given by the Act of 1901 and renewed in 1923, the Government of India framed during 1929 regulations whose effect was to exclude women from underground workings forthwith, except in exempted mines, that is except in coal-mines in Bengal, Bihar and Orissa and the Central Provinces, and salt-mines in the Punjab. In these exempted mines exclusion was to be gradual, so that after 1 July 1939 women were to be entirely excluded from underground workings. In view of the special needs of war-time production, the ban on the employment of women underground was temporarily suspended in 1943 but was reimposed with effect from 1 February 1946. The Indian Mines Act of 1923 did not place any statutory restrictions on the daily hours of work. In March 1928, therefore, the Legislature passed an amending Act under which no mine was allowed to work for more than twelve hours out of twenty-four through the same set of workmen. Owners were required to put up notices outside the offices stating the hours of work. The following are some of the changes introduced by the amending Act of 1935.

No person is allowed in a mine on more than six days in any one week. A person employed above ground in a mine is not allowed to work for more than fifty-four hours in any week or for more than ten hours in any day. The periods of work of any such person are so arranged that, along with his intervals for rest, they are not in any day to spread over more than twelve hours, and that he is not to work for more than six hours before he has had an interval for rest of at least one hour. A person employed below ground in a mine is not allowed to work for more than nine hours in any day. Work of the same kind is not to be carried on below ground in any mine for a period spreading over more than nine hours in any day except by a system of relays so arranged that the periods of work for each relay are not spread over more than nine hours. The employment of children under fifteen years of age in any mine is prohibited.

In addition to the Mines Acts, conditions of employment in mines are regulated also by the appointment of Mines Boards of Health which look after the health of the labour force. A Board is empowered to compel the owners of mines within the mining settlement area to provide housing, water-supply, sanitary facilities and medical help.

That much still remains to be done for the safety of workers in mines became painfully obvious when a number of serious disasters occurred in the collieries a few years ago. An expert committee was appointed in 1937 to investigate the causes of these disasters. The Committee's description of the coal-mining industry is worth quoting: 'In short, to use a sporting metaphor, the coal trade in India has been rather like a race in which profit has always come in first, with

safety a poor second, sound methods an "also ran", and national welfare a "dead horse" entered, perhaps, but never likely to start.'[1]

§31. **Labour legislation for railways.**—All railway workshops come under the administration of the Factories Act of 1922. The Indian railways employ nearly a quarter of a million workers in other occupations for which, until recently, no provisions controlling hours of work, etc., were made, in spite of the ratification by the Government of India of the Washington (1919) and Geneva (1921) Conventions in their application to railways in British India. The problem was beset with many difficulties which were overcome by the Indian Railway (Amendment) Act of 1930 which gave effect to the Government's statutory obligations under the International Labour Conventions. A railway servant must not be employed for more than sixty hours a week on the average in any month. A railway servant whose employment is essentially intermittent cannot be employed for more than eighty-four hours in any week. Temporary exemptions of railway servants from the above provisions may be made (i) in case of emergency involving serious interference with the ordinary working of the railway and (ii) in cases of exceptional pressure of work, overtime being paid only in the latter class of cases. A weekly rest of a full twenty-four hours is prescribed, subject to temporary exemptions as above. Compensatory periods of rest for the period forgone must be granted. The Governor-General-in-Council could appoint supervisors of railway labour to inspect railways in order to determine if the provisions of the Act are duly observed.

§32. **Workmen's Compensation Act of 1923 (as subsequently amended).**—The right of the worker to be insured at the expense of the industry for all accidents in the course of the worker's regular employment and as a result of the risks taken in that employment, has received legal recognition in most Western countries. The progress of the idea of compensation for accidents has been slow in India. As far back as 1884, workers in Bombay made a demand for the introduction of compensation. Although a certain number of enlightened employers instituted such a system for their work-people, the practice was by no means generally adopted. Prior to the Act of 1923, an employer could be sued under the Fatal Accidents Act of 1885 in case of death arising from an accident. But this Act was seldom invoked. Further, with regard to the general question of employer's liability the position was vague.

The principle of the Act of 1923 was that compensation should ordinarily be given to workmen who had sustained injuries by accidents arising out of and in the course of employment, compensation being also given in certain circumstances for diseases. Although the measure followed in general principles the legislation in force elsewhere, it also struck a certain distinctive note and was adapted to meet the peculiarities of industrial life in India. The scope of the Act, which was originally limited, was considerably widened by amending Acts passed in 1926, 1929, 1931 and 1933. This was made necessary partly by the ratification by the Government of India of the draft convention regarding workmen's compensation for occupational diseases adopted by the Seventh International Labour Conference (1925) and partly by the recommendations made by the Royal Commission on Labour in 1931. The Act of 1923 was an experimental measure and has now been

[1] See Shiva Rao, op. cit., p. 239.

replaced by the amending Act of 1933. Certain minor amendments of a technical character were effected in the year 1939.

The Act of 1933 covers railways; tramways; factories; mines; seamen; docks; persons employed in the construction, demolition or repairs of certain buildings or of roads, bridges and tunnels; marine works; operations relating to telegraph, telephone, or overhead electric lines; blasting operations or excavations; boat services; lighthouses; tea, coffee, rubber or cinchona plantations; electricity or gas generating stations; cinematograph workers; salaried motor drivers; and underground sewage workers. In all cases persons employed in an administrative or clerical capacity and those whose monthly earnings exceed Rs. 300 are excluded. The Act covers over seven million industrial workers in the country.

The amount of compensation payable depends on the average monthly earnings of an injured or deceased workman. The amounts of compensation payable in the case of an injured workman whose monthly wages are not more than Rs. 10 are Rs. 500 for death, Rs. 700 for permanent total, and half the monthly wages for temporary, disablement. For a workman whose monthly wages are between Rs. 50 and Rs. 60, the corresponding figures are Rs. 1,800, Rs. 2,520 and Rs. 15 respectively. The maxima for persons earning over Rs. 200 per month are Rs. 4,000, Rs. 5,600 and Rs. 30 per month respectively. In the case of minors the amounts of compensation for death and for permanent total disablement are at a uniform rate of Rs. 200 and Rs. 1,200 respectively, and half the monthly wage for temporary disablement. No compensation is payable in respect of a waiting period of seven days following that on which the injury was caused.

The dependants to whom the amount of compensation is payable are firstly those who are actually dependants such as a wife or a minor child; and secondly those who may or may not be in that position such as a husband, a parent other than a widowed mother, etc. Provision is made for enabling the interests of dependants, in cases of fatal accidents, to be better safeguarded, by ensuring that such accidents should be brought to the notice of commissioners, appointed under the Act by Provincial Governments.

The general administration of the Act and the settlement of disputes thereunder are entrusted to these commissioners, who have been given wide powers. The procedure is simple and opportunities for appeals restricted. For the success of a measure like this, rapid inquiry by medical men capable of forming estimates of the injuries received, along with the enlistment by the State of impartial judges to see that the worker gets the benefit that is due to him, are necessary. The migratory habits of the industrial worker, his ignorance of the financial relief to which he is entitled under the Act, and lack of men qualified to put up the workmen's case for compensation are some of the factors which render the operation of a measure of this kind difficult in India. The Workmen's Compensation (Amendment) Act, 1946, raises the maximum limit of earnings on which compensation is payable from Rs. 300 per month to Rs. 400 per month and lays down a scale of compensation for those earning between Rs. 300 and Rs. 400 per month.

It may be mentioned that, contrary to the fears of many employers, the Workmen's Compensation Act has not appreciably increased the cost of production, while it has greatly improved the standard of safety.

§33. **Social insurance.**—The principle of social insurance for the protection of the industrial worker against the hardships arising from sickness, unemployment and old age has long been recognized in industrial countries like the United Kingdom and Germany. International labour organizations have also lent their support to social insurance by adopting from time to time conventions regarding all these matters. Some of these questions have been receiving the attention of the Government of India and other parties concerned, particularly since the Tenth International Labour Conference (1927) adopted a convention in respect of sickness insurance for industrial, agricultural, and domestic workers. The Congress Ministry in Bombay visualized the development of a comprehensive system of social insurance and had under consideration the feasibility of legislation for the grant of leave with pay during periods of sickness, in the hope that it would pave the way for sickness insurance.[1]

There are considerable difficulties, administrative, financial and otherwise, in the way of the introduction and enforcement of social insurance in India, such as absence of the requisite statistical and actuarial basis for the various forms of social insurance. As regards agricultural labour, it is casual in nature and there is absence of qualified medical men in the districts. A committee of inquiry called the Labour Investigation Committee was appointed early in 1944 by the Governor-General-in-Council which made exhaustive fact-finding surveys in about thirty-six industries. The findings of this Committee have provided some solid basis for the formulation of policy. One of the relevant considerations in social insurance schemes is the capacity of industry to bear additional burdens thus imposed on it. It is desirable that social insurance schemes should be based on a contributory basis as in other countries, the employers, the workers and the State all bearing their fair share of the burden. It is also desirable that such action as is taken in these matters should be on an all-India basis, lest industries in one province should be penalized while those in other provinces or Indian States escape.

The Employee's State Insurance Act, which was passed in April 1948, provides for compulsory state insurance against sickness and employment injury and provides maternity benefit for all employees of factories, both manual and clerical, earning less than Rs. 400 per month. The State Governments are to bear the cost of medical care and treatment. Sickness Cash Benefit will be paid for a maximum of eight weeks in a year. Disablement benefits will be paid for the period of disablement resulting from an employment injury. Provision has also been made for paying Dependants' Benefits to widows, daughters and sons, subject to certain conditions.

§34. **History of industrial disputes in India.**—On the whole, before 1917 strikes were rare in India. In 1905 there were several strikes in Bombay owing to the introduction of electricity which favoured excessively long hours of work. It was, however, during the war of 1914-18 that the strike came to be regarded as an ordinary weapon of industrial warfare. The economic upheaval and the general feeling of unrest created by the war, the increase in the cost of living due to rise in prices, and the spread of class consciousness have produced a large crop of strikes

[1] *Labour Gazette* (Bombay), August 1937, p. 923.

since 1917. The position became specially acute in 1919-20, when a great strike occurred in Bombay involving 150,000 cotton mill workmen. Among the contributory causes of these strikes have been long hours of work; bad housing; lack of provision, till recently, for compensation for injuries received; the ill-treatment of the workers by foremen; the sympathy of one group of strikers for others, and so on.

The strike situation was very serious in 1919-21 owing to the economic distress and high prices induced by the war. With the gradual restoration of normal conditions and a fall in the cost of living, the strike fever appeared for some time to be subsiding. The increased wages granted during the war remained as they were for some time after it, in spite of a fall in prices, thus securing some increase in the real wages of labour. The depression which followed the post-war boom, however, led to a movement on the part of employers of labour to stop paying war bonuses or to decrease wages, causing a fresh outburst of strikes at industrial centres like Bombay and Ahmedabad. The years 1926 and 1927 were comparatively quiet. The year 1928, however, saw a recrudescence of industrial unrest, and the outbreak of several big strikes all over the country, e.g. the big st ike in the Bombay cotton mills in October 1928, following an attempt on the part of the millowners to introduce rationalization and new methods of work. The intensification of these strikes as well as the unusually prolonged duration of some of them was attributed to Russian communist influences and the secret help derived from the same quarter. A prolonged strike in the Iron and Steel Works at Jamshedpur and strikes on several railways, threatened or actual, and accompanied, in the case of the E.I.R. and S.I.R. strikes, by considerable violence, were a feature of the year 1928. In the year 1929 the industrial strife of the previous year persisted and communist influences were evident. There was again a general strike in the cotton mill industry in Bombay. These stormy years were followed by comparative calm throughout the country. The economic depression (1929-33), particularly in the cotton mill industry, ushered in a period of wage-cuts and this resulted in a number of short-lived strikes. The Bombay Government instituted a Departmental Inquiry into the question of wage-cuts in the province. The report of this inquiry was published in June 1934 and the semi-general strike, which had been declared in Bombay mills while the inquiry was in progress, was called off almost simultaneously. The most important result of this inquiry was the passing by the Government of Bombay of a Trade Disputes Conciliation Act which is reviewed in §37 below. For a period of nearly three years after the passing of the Act there was little industrial strife in the cotton mill industry in the Bombay city. The year 1937 was marked by a recrudescence of labour troubles in Bombay, Ahmedabad, Cawnpore, Madras and other industrial centres in India caused partly by the demand for higher wages and restoration of wage-cuts on the ground of industrial and business recovery, and partly by communist activity in labour circles. The acute discontent in the ranks of workers, in spite of the ameliorative legislation of previous years, was reflected in the large number of strikes in 1937 and 1938, when there were as many as 379 and 399 industrial disputes respectively as compared with an annual average of 147 strikes during the thirteen years 1924-36. It was in 1937 and 1938 that the Congress Governments instituted labour inquiries, either confined to textile

labour as in Bombay (1937) and the Central Provinces (1938), or of a general character as in the United Provinces (1937) and Bihar (1938).

§35. **Industrial disputes since 1939.**—The total number of disputes in the year 1939 was 406, the highest number till then recorded.[1] The number of disputes in 1942 was even higher, viz. 694.[2] The principal cause of labour unrest since the war has been the continuous rise in prices and cost of living due to currency inflation. In the race between wages and prices, wages are being constantly left behind. This position can only be rectified when prices are effectively controlled and stabilized. While profits in many cases have reached unprecedented heights, the condition of the labouring classes as a whole has deteriorated. Labour unrest, as manifested by the strike mania which has recently swept over the country, is also to be attributed to some extent to political and social causes as well as to the activities of communists. But the main influence is undoubtedly the disparity between prices and wages.

§36. **Prevention of industrial disputes.**—Before dealing with the machinery for the settlement of industrial disputes *after* they have broken out, a few words may be said regarding the methods of preventing them. The first essential is the creation of sound organizations both of employers and employees. The employers are for the most part sufficiently well organized in India, but not so the workers. Hence the importance of strong trade unions. Efficient organizations on either side, competent to speak for their respective sides, will tend to prevent the occurrence of sporadic strikes and lock-outs and formulation of grievances after rather than before going on strike—features which are peculiar characteristics of strikes in India. A permanent Arbitration Board has been established for the settlement of disputes in the textile industry in Ahmedabad. The Bombay Industrial Disputes Committee of 1922 as also the Labour Commission recommended the formation of Works Committees or Shop Committees on the lines of the Whitley Committees in England. On these committees the workers would be represented along with the employers and would be responsible for the fixing and observance of conditions under which work is to be carried on. It may be mentioned that such committees have already been established by some enlightened employers like Tatas, and by the Government in their capacity as employers.

We may now proceed to discuss the arbitration and conciliation methods for settling industrial disputes. The numerous disputes after the war of 1914-18 showed the necessity of suitable machinery for investigating and settling them. The Government of Madras were the first to take steps in this direction by setting up courts of inquiry to deal with individual disputes as they arose. The Committees appointed by the Bengal Government (1921) and the Bombay Government (1922) did valuable spade work and made a number of detailed recommendations regarding the machinery to be set up for preventing and settling disputes. The Government of India held that the subject was one for all-India legislation. This, however, was held to be premature until the Trade Union Bill had been passed. The Trade Union Bill became law in 1926 and came into force the next year. The

[1] *Labour Gazette* (Bombay), June 1940, p. 896.

[2] During the year 1946, there were more than 300 strikes in Bombay city alone till the month of August. Other labour centres were similarly affected.

Trade Disputes Act, which was passed in 1929 and was to remain in force for a period of five years only in the first instance, was made permanent in 1934.

Since 1940 the Government of India have gradually evolved and perfected a new consultative body, viz. the Indian Labour Conference (Tripartite Labour Conference). All parties concerned with labour—the Government of India, the provinces and States, employers' organizations and workers' organizations—are represented in the Plenary Labour Conference which meets once a year. The Conference has a Standing Committee which meets more often. Most labour legislation is previously discussed by the Plenary Labour Conference and the Standing Committee before being formally brought before the Legislature and its passage through the Legislature is facilitated because in the previous discussion all the different viewpoints have a chance of being heard and of influencing the final shaping of the proposals.[1]

§37. **Trade disputes legislation.**—(i) *The Trade Disputes Act of* 1929.—The Act closely follows the English legislation on the subject and does not provide for *compulsory* arbitration. As in England, public opinion is regarded as the decisive factor in settling disputes and the underlying idea is to help the clear framing and discussion of the issues by an impartial tribunal, so that a well-informed public opinion may be formed. The act provides for the setting up of Courts of Inquiry and Conciliation Boards.

(*a*) *Nature of inquiry.*—The Provincial Government or the Governor-General-in-Council, where the employer is the head of a department under the Governor-General-in-Council or a railway company, is authorized to appoint, for preventing or settling a dispute, a Court of Inquiry or Board of Conciliation, as the case may be, where both parties to the dispute apply, separately or conjointly, provided the persons applying represent the majority of each party.[2] (*b*) *Constitution of the Court of Inquiry.*—The Court of Inquiry consists of an independent chairman and such other independent persons as the appointing authority may think fit or it may consist of one independent person. (*c*) *Board of Conciliation.*—The Board of Conciliation has a different constitution and consists of a chairman and two or four other members as the appointing authority thinks fit or it may consist of one independent person. The chairman is an independent person and the other members may be either independent persons, or persons appointed in equal numbers to represent the parties to the dispute on the recommendations of the parties concerned. (*d*) *Procedure.*—The duty of such a Board is to endeavour to bring about a settlement after investigation of the merits of the dispute and to do all such things as it may think fit to induce the parties to come to a fair and amicable settlement and give them reasonable time for doing so. In case of failure to bring about a settlement, the Board is to send a full report to the appointing authority setting forth the proceedings and the steps taken by the Board for the settlement of the dispute together with its findings and recommendations. The appointing authority is to publish the report, final or interim, as soon as possible

[1] See *Eastern Economist*, 19 July 1946, article on 'Labour and the Legislature,' pp. 99-100.

[2] The Labour Commission recommend that the possibility of establishing permanent courts in place of *ad hoc* tribunals under the Act should be examined (*L.C.R.*, 346).

after its receipt. (*e*) *Strikes in public utility services.*—The provisions in the second part of the Act regarding public utility services are among the most important in the whole Act. A public utility service means (1) any railway service so declared for the purposes of the Act by the Governor-General-in-Council; (2) any postal, or telegraph or telephone service; (3) any business or undertaking which supplies light or water to the public; and (4) any system of public conservancy or sanitation. Special penalties are laid down for employees, employed on monthly wages, in such services in the event of their going on strike in breach of contract without having given to their employer, within one month before so striking, not less than fourteen days' previous notice. Employers carrying on such public utility services are made liable to be fined (the fine being heavier in their case) for locking-out their employees without a similar notice. Abettors of an offence, as defined above, are left to be dealt with under the ordinary Criminal Amendment Law. (*f*) *Illegal strikes.*—There are also special provisions in respect of illegal strikes on the lines of the British Trade Disputes Act of 1927. A strike or lock-out is to be regarded as illegal which (1) has any object apart from the furtherance of a trade dispute within the trade or industry in which the parties to the dispute are engaged; and (2) is designed or calculated to inflict severe hardship upon the community, and thereby to compel the Government to take or abstain from taking any particular course of action. Any sums collected or applied in direct support of such strikes are illegal. Sympathetic strikes are declared illegal by defining a trade dispute within an industry as one which is between the employers and the employees of that industry with regard to the employment in that industry alone. The trade union privileges of members are protected from invasion on the ground of a refusal to join such illegal strikes.

The Act presupposes organization on the part of the employers and the employees, and, as already suggested, is intended to promote such organization, to check sporadic strikes and arbitrary lock-outs, and to help the formulation of grievances before and not after a strike is declared. Sympathetic strikes are by implication illegal under the Act. This has been criticized by labour leaders as giving the Government power to declare any big strike illegal. But, on the other hand, a general strike like the triple strike in England (1926) may be a real menace to the community. Like many other provisions of law, therefore, this particular provision cannot be demurred to merely because it is liable to be abused. It has also been argued that the clauses regarding illegal strikes interfere with the fundamental human rights of the workmen and further that they will tend to choke the trade union movement in India in its infancy, and will create distrust in the mind of the workers. The view is held by some critics that the portions of the Act dealing with strikes in public utility services and illegal strikes were unnecessary. Sudden strikes in social security services, such as the supply of water, light and sanitation, are already illegal and punishable under the Penal Code. Strikes in ordinary public utility services (as distinguished from security services) such as the postal, telegraph or telephone service, or even the railway service, however, need not be dealt with severely.[1]

[1] A Bill to amend and widen the scope of the Trade Disputes Act (1929) was passed by the Central Legislature in April 1938. It alters the definition of an illegal strike; includes

During the period of eight years between the passing of the Act and the introduction of provincial autonomy, the Trade Disputes Act was made use of on only five occasions. Since August 1937, when popular ministries assumed power, the Act has been put into force more frequently, especially in the province of Madras. The procedure in connexion with the appointment of the Court of Enquiry and Boards of Conciliation under the Act has been found to be cumbrous and inconclusive in character, and these defects led the Government of Bombay to pass provincial legislation in 1934 (see iii below).

(ii) The Labour Commission recommended that every Provincial Government should have an officer or officers to undertake conciliation. The Commissioner of Labour in Madras, the Director of Industries in the Punjab, the Director of Statistics, Deputy Commissioners and the Director of Industries in the Central Provinces, have accordingly been given powers as conciliation officers.

(iii) *The Bombay Trade Disputes Conciliation Act* (1934) provided for the appointment of the Commissioner of Labour as *ex officio* chief conciliator and also for the appointment of a Labour Officer, special conciliators and assistant conciliators. A Labour Officer was appointed in 1934 to guard the interests of the workers. The Millowners' Association also appointed a Labour Officer of its own to represent mill managements in proceedings with the Government Labour Officer and the chief conciliator.[1]

(iv) *The Bombay Industrial Disputes Act* (1938).—The object of the Bombay Industrial Disputes Act of 1938, which supplants the earlier Act of 1934, is to ensure that the machinery of conciliation and arbitration provided for by it shall be fully exhausted before a strike or lock-out can be declared.

The Act provides for the registration of unions which have been recognized by the employers concerned or which fulfil certain requirements as regards membership. Registration confers various rights on the unions in connexion with representations on behalf of the workers. Labour Officers and conciliators may be appointed for different areas or industries in the province, and machinery is set up to ensure that the grievances of workers or any alteration in their conditions of service are fully considered. Strikes and lock-outs are therefore made illegal until the whole of the machinery for discussion and negotiation provided for by the Act has been made use of. The right to declare a strike or lock-out must be exercised within a period of two months after the completion of conciliation proceedings. Conciliation starts functioning immediately if a dispute is likely to occur, because the Act provides that an employer or a workman desiring to make a change in wages or hours or other conditions of employment must give notice of his intention to do so to the prescribed authorities, and no change can be effected until the machinery of the Act has functioned to the fullest extent.

In areas and in industries where the workmen concerned are members of a recognized union the conduct of all negotiations is left to the employers and to the

within the list of utility services any inland steam vessel and tramway service which the Government may notify and any undertaking which supplies power to the public; and provides for the appointment of conciliation officers by Provincial Governments.

[1] Similar Labour Officers have since been appointed in Bengal, the United Provinces, Madras and Bihar.

union. In cases where there are no recognized unions, directly elected representatives of the workers concerned or the Labour Officer will conduct the preliminary discussions on behalf of the workmen. If agreements are reached during these discussions such agreements will be registered. If the parties fail to reach an agreement, a trade dispute will be considered to have occurred and the official conciliator will step in and endeavour to bring about a settlement of the dispute. If the conciliator fails, or if the Government otherwise orders, a Board of Conciliation may be appointed.

In industries and centres where employers and unions have agreed to refer disputes to arbitration, the official machinery will not be brought into operation in the earlier stages and may or may not operate in the later ones. However, all agreements and awards arrived at are to be registered.

A Registrar has been appointed under the Act whose duties include the registration of unions and the determination of their eligibility, recording of agreements and awards and other notices and reports provided for in the Act.

In one important particular the Act breaks entirely fresh ground, for it makes provision for the setting up of an Industrial Court presided over by a High Court Judge or a lawyer qualified to be a High Court Judge. This court is to act as a tribunal for voluntary arbitration on matters submitted to it by the parties to a dispute. It will also function as a court of final appeal in numerous cases arising out of the working of the Act. The court is to be the tribunal that is to decide whether or not a strike or lock-out is illegal, and all questions of interpretation of agreements and awards will come before it. Such a court has already been established under the Act.

The Bombay Industrial Disputes Act of 1938 is the most advanced and outstanding piece of labour legislation in this country. The Act has been criticized as being unduly drastic and hostile to the free right of the workers to declare a strike. On the other hand, it is pointed out that it does not take away the right to strike, but only requires postponement of its use until peaceful methods for securing the settlement of a trade dispute have been fully utilized.

'Another criticism of the Act is that it does nothing to recognize the value of an internal organization for overcoming the psychological differences that hamper the co-operation of the work-people', as the basic idea underlying the Act has been the introduction of collective bargaining between the whole body of employers in a local centre and the whole group of organized workers in that area.[1]

During the 1939-45 war the necessity of additional legal provisions 'which would not only be elastic enough but which would also provide for some definitive method for the settlement of disputes' was felt. This was the underlying motive of Defence of India Rule 81A passed by the Government of India in 1942 which severely limited the liberty of workers to go on strike. The Essential Services (Maintenance) Ordinance of 1941 was of a similar character and its object was to prevent workers in services declared by the Government as 'essential' from leaving their employment.

(v) *The Bombay Industrial Relations Act* (1946) is intended to take the place of

[1] See *Indian Journal of Economics*, Conference Number, 1940, article on 'Industrial Disputes and Legislation' by P. S. Lokanathan.

the Industrial Disputes Act (1938) of which most of the provisions are retained although a number of new features have been introduced. Experience has proved that adjudication has brought a large measure of success and greater benefits to labour, and the Act attempts to extend the scope of adjudication by compulsory arbitration. The machinery set up for the settlement of disputes, with Labour Courts with powers to impose penalties and a higher Industrial Court with appellate jurisdiction, aims at insuring a quick decision in disputes and preventing economic paralysis by sudden stoppages of work.

(vi) *The Industrial Disputes Act* (1947).—The Industrial Disputes Act (1947) provides for an elaborate conciliation machinery. If an industrial dispute occurs or is feared, the conciliation officer is to inquire into it and help the parties to come to an amicable settlement. He is required to submit the report of his inquiry within 14 days to the appropriate Government. If the conciliation officer fails to bring about an amicable settlement the matter is to be taken up by a Conciliation Board with an independent chairman and two to four other members. The Board is expected ordinarily to complete its work within two months. If the Board succeeds in bringing about an agreement, this is to remain in force for six months or a mutually agreed period whichever is the longer. Provision is made for the appointment of a Court of Inquiry to investigate the questions in dispute referred to it. The Court is to consist of one or more independent persons and must submit its report to the appropriate Government within six months. Provision is also made for setting up Industrial Tribunals composed of High Court Judges. Their award is to be binding for six months or an agreed period whichever is the longer. Strikes or lock-outs are not permissible during the pendency of conciliation proceedings.

The Act provides for the establishment of Works Committees in industrial establishments employing one hundred or more workmen. These committees are to consist of representatives of employers and workmen, and the number of workmen's representatives, to be chosen in consultation with registered Trade Unions of workmen, is to be at least equal to that of the employers. The function of the Works Committees is to promote measures for securing and preserving amity and good relations between employers and workmen and enable both to meet each other informally and settle differences as they may arise from day to day. The Act accepts the principle of compulsory arbitration. This has been strongly opposed as violating the workmen's rights of collective bargaining and concerted action and depriving labour of its most powerful weapon against the employer, viz. the strike. On the other side it is argued that it is desirable that Government should have the power of enforcing compulsory arbitration when the interests of the community as a whole demand it. It is further pointed out that as a rule the method of conciliation will in practice be resorted to and moreover the Act provides for voluntary arbitration. The possibility of Government insisting on compulsory arbitration is calculated to make the parties to the dispute more amenable to reason than they might otherwise be and more willing to come to an agreement.

The clause in the original Bill prohibiting sympathetic and political strikes was deleted as a concession to labour representatives. This, however, would seem to defeat the object of the Act, which is to minimize industrial conflict without

trenching too much upon the rights and liberty of labour. The right to strike for better wages or better living conditions for oneself may be considered as fundamental but not the right to strike in sympathy with others or for political objects.

§38. **Trade Union Movement in India.**—Already in 1918 trade unions were organized in Madras under the leadership of Mr B. P. Wadia. From Madras the trade union movement spread to Bombay. The industrial unrest, which may be said to have commenced in 1917, resulted in the creation of a number of labour organizations. These were, however, temporary in character and dissolved into thin air as soon as their immediate object, whether it was increase of wages or any other thing, was fulfilled. They were 'little more than strike committees consisting of a few officers and perhaps as few paying members'.[1] This situation has, however, been gradually improving. In the initial stages of the movement the presence of actual economic distress was practically the only bond among the workers, which tended to weaken when conditions were more favourable. Latterly the movement has shown distinct signs of vigour and has been helped by the Trade Union Act of 1926. Moreover, the trade union movement in India has almost from its inception had the advantage of an all-India organization like the All-India Trade Union Congress which has been holding annual sessions since 1920.[2] The creation of the International Labour Office hastened the establishment of a central trade union organization in India. The presence of its representatives at the annual Labour Conferences at Geneva has brought the Indian movement into direct touch with the movement in the Western world.

The All-India Trade Union Congress had in 1940 a total number of 191 Unions with 354, 541 members affiliated to it. The total number of registered trade unions under the Trade Union Act of 1926 (see § 40) was nearly 700 in September 1939. During the same month the total membership of these 700 Unions was considerably over half a million.[3] In 1946-7 the number of registered Trade

[1] See Hurst, op. cit., p. 101.

[2] In 1929, there occurred a serious split in the ranks of the Trade Union Congress and there came into existence three distinct groups—the communist group, the liberal group and the rest. Unification of the Indian Trade Union movement was effected at the joint session of the two principal bodies in April 1938. The Trade Union Federation was absorbed into the Trade Union Congress at the session of the Congress held in 1940. There was, however, another split at the session of the Congress held in Bombay in September 1940, caused by its adoption of a resolution of neutrality with the war effort. Dr Aftab Ali, President of the Seamen's Union at Calcutta, desiring to support the war effort, disaffiliated his Union from the Congress. Another section, headed by Mr M. N. Roy and Mr Jamnadas Mehta, also formed a new central organization known as the Trade Union Federation with its head office at Delhi. During the last few months of 1948 and the first few months of 1949, several unions seceded from the Trade Union Congress which has been captured by the Communists. Recently an organization following the ideology of the Congress and calling itself the Indian National Trade Union Congress has come into existence in Ahmedabad and is gradually gathering strength. Another powerful organization is the Hind Mazdoor Panchayat established by the Socialists under the leadership of Jai Prakash Narain.

[3] Messrs Purcell and Hallsworth, British Trade Union delegates to India, calculated that there were in all 25,266,109 persons in the organizable groups of workers (including 21,676,107 agricultural field and farm labourers, but excluding domestic servants and Postal and Government office employees) in the various industries in India. See *Report on Labour Conditions in India* (British Trade Union Congress Delegation, 1928), p. 15.

Unions was 1,725 of which 998 submitted returns and showed a membership of 1,331,962. The percentage of female workers was very small, being less than 4 per cent of the total membership. Not all these unions, however, are equal in strength and vitality. About half of them are organizations either of Government servants or of persons connected with Government employment. Trade unionism has met with comparatively greater success among railway and postal employees, but on the whole it is weak in the great organized textile and mining industries. The Ahmedabad Textile Labour Union is, however, the biggest and best organized trade union in India.

§39. **Difficulties of the movement in India.**—The special difficulty of the trade union movement is, in the first place, the floating character of the labour population (see § 3). In the second place, labour in centres like Bombay and Calcutta consists of a heterogeneous mass of men speaking a variety of languages and, therefore, not feeling intimately drawn to each other. Where, however, the proportion of emigrant labour is small, as in Ahmedabad, the trade unions are much stronger than elsewhere. Thirdly, many labourers dislike the idea of regular contributions and union discipline, and this accounts for the small percentage of men enrolled in any establishment. Even a small contribution is felt as a burden owing to the great poverty of the average worker. Fourthly, the majority of the workers are illiterate and are, therefore, unable to find leaders from their own ranks. This accounts for a special feature of the trade union movement in India, namely that it has been largely led by men from the middle classes,[1] professional lawyers and others who have not in all cases distinguished between political and economic considerations. Moreover, their interests are divided amongst many unions and their knowledge of technicalities is generally slight. Another handicap is the absence of a true democratic ideal, which is so essential for effective trade unionism. Lastly, successful trade unionism depends on at least a temporary acceptance of the existing social order with a view to gaining as much for labour as possible.[2] If working-class leaders are frankly out to destroy the present capitalistic order of society their influence must weaken the trade union movement. According to many competent observers this points to one of the principal reasons for the weakness of the movement in Bombay as contrasted with the striking success it has achieved in a centre like Ahmedabad. The representation given to labour in the Provincial Legislative Assemblies under the Government of India Act (1935) through special constituencies comprising registered Trade Unions was expected not only to promote registration of new unions, but also to ensure maintenance of proper accounts and registers of members.

§40. **Trade Union Act of 1926.**—A decision of the Madras High Court at the end of 1920, giving an injunction restraining trade union officials or organizers from influencing labourers to break their contracts with their employers by striking to

[1] 'As in the early days of British trade unionism, when it had to rely largely upon men like Robert Owen, Francis Place, and later, Kingsley, Ludlow and Frederic Harrison, so too the Indian movement in its corresponding stage is almost wholly dependent upon the lawyer or "pleader" class for its union presidents and secretaries.'—Ibid. For some interesting comments on this subject see *L.C.R.*, pp. 324-5, 328-9.

[2] Ahmad Mukhtar, *Trade Unionism and Labour Disputes in India.*

obtain increased wages, revealed the necessity of legislation for the registration and protection of Indian trade unions. Mr N. M. Joshi, the Labour Member, first brought the question before the Assembly in March 1921 and his persistent efforts in this connexion finally bore fruit when the Trade Union Act passed in 1926 came into force on 15 June 1927. The Act defines the legal position of Indian trade unions in definite and precise terms. The registration of trade unions is optional, but the Act confers certain valuable privileges on the registered bodies denied to those that choose to remain unregistered. The registered trade union is required to define its name and the objects for which it is established. It must keep a list of members and provide for a regular annual audit of its funds which must be spent on certain specified objects calculated to promote the obvious interests of the members. Not less than one-half of the office-bearers of a registered trade union must be persons employed in the industry concerned. As against these restrictions, the Act grants immunity from criminal liability to all trade union officials acting in furtherance of legitimate objects of the union. Nor are they liable to be indicted for conspiracy. The Act provides that (i) no suit shall be maintainable in any civil court against any officer or member of a registered union in respect of any act done by him in contemplation or furtherance of a trade dispute on the ground only that such act induces some other persons to break a contract of employment or is an interference with the trade, business, or employment of some other person or his right to dispose of his capital or labour as he wills ; and that (ii) no suit shall be maintainable in any civil court against a registered trade union in respect of any act done in contemplation or furtherance of a trade dispute by any person acting on behalf of a trade union, provided it is proved that such person acted without the knowledge of or contrary to express instructions given by the executive of the trade union. A registered trade union may create a fund for the promotion of the civil and political interests of its members, the contributions however being on a strictly voluntary basis.

INDUSTRIAL WELFARE[1]

§41. **Nature of welfare work.**—Welfare work has been variously defined. One definition confines it to voluntary efforts on the part of employers to provide the best conditions of employment in their own factories. A definition more generally accepted includes within the scope of welfare work 'all efforts which have for their object the improvement of the health, safety and general well-being and the industrial efficiency of the worker'.[2]

These efforts may be made by employers of labour, or the State, or the employees themselves, or by social agencies. From one point of view, these activities may be regarded as humanistic, aiming at the welfare of the industrial population. From the narrower and purely utilitarian point of view, so-called 'welfare work' may be regarded as 'efficiency work' having a direct favourable reaction on the physical contentment and efficiency of the operatives and thus helping to counteract the migratory tendencies of Indian labour. Welfare work may also be considered

[1] On this subject read *L.C.R.*, ch. xiv.

[2] Presidential Address, All-India Industrial Welfare Conference, 1922.

as a means of developing a sense of responsibility and dignity amongst an illiterate class of workers, making them good citizens.

§42. **Divisions of welfare work.**—Welfare work falls into two broad classes: (i) activities inside the factory, or intra-mural welfare work, and (ii) activities outside the factory, or extra-mural work. As regards intra-mural work for improving conditions of work inside the factory, an account of what has already been done by the State and, to a smaller extent, by employers, has been given earlier in the chapter.

In the past, welfare work, especially in regard to the proper utilization of leisure time, has received little attention at the hands of employers of labour, and such efforts as have been made have mostly taken the form of providing medical aid, minor educational facilities and housing. It is, however, receiving increasing attention at the present time, owing to the serious growth of industrial unrest. The Social Service League of Bombay was able, in 1918, to induce two enlightened mill agents to entrust to it the organization and management of two workmen's institutes for the benefit of operatives working in mills under the agencies of Currimbhoy Ebrahim & Sons and Tata Sons. In 1922 an All-India Industrial Welfare Conference was held in Bombay. It discussed several interesting problems connected with welfare work and was able to effect some co-ordination of work carried on by various agencies at the different centres. The All-India Trade Union Congress has also been directing its attention to welfare work for some time past. In May 1926 the Government of India asked all the Provincial Governments to collect full information with regard to the steps taken and efforts made to ameliorate the conditions under which the workers live when not actually employed. This inquiry was undertaken in response to a recommendation adopted by the Sixth Session of the International Labour Conference requesting the various Governments concerned to supply the International Labour Office with up-to-date information regarding the use of the worker's spare time.

Besides the interest shown by some of the more enlightened employers in Bombay, several employers of labour at other industrial centres have also instituted welfare schemes for the benefit of their operatives in Madras, Nagpur, Jamshedpur, and Cawnpore. The welfare work carried on by the Buckingham and Carnatic Mills in Madras for many years past is well known. At Nagpur, the Empress Mills have entrusted the task of looking after the welfare of their employees to the Y.M.C.A. The Board of Directors of the Tata Iron and Steel Company at Jamshedpur have put forward the claim that 'the attitude of the company from its earliest days towards labour and its provision of housing, education, welfare, water-supply, drainage, hospital, and other public services on a scale unexcelled in India, have met with the approval of public men of all shades of thought'. At Cawnpore, the British India Corporation have provided for a Welfare Superintendent to manage the two settlements that have been built to house their workers. Some of the municipalities, like the Bombay Corporation, Port Trust and public utility services, especially railways, have also taken steps to promote the welfare of their employees. Lastly, several social service agencies, such as the Bombay Social Service League started by the Servants of India Society, and similar leagues in Madras and Bengal, the Seva Sadan Society, the Bombay Presidency Women's Council, the Maternity

and Infant Welfare Association, the Y.M.C.A., the Depressed Classes Mission Society, and missionary societies, are all playing a useful part in the organization of welfare work both by helping employers of labour and by independent efforts.

Under provincial autonomy most of the Provincial Governments took active measures to supplement the welfare and recreational activities undertaken by employers and other agencies mentioned above, by initiating large welfare schemes of their own. The Government of Bombay for instance, opened welfare centres in the industrial areas in Bombay and other cities in the province.[1]

The Cawnpore Labour Enquiry Committee in their Report (par. 31) urged the establishment of a Welfare Council containing representatives of various institutions interested in this work.

§43. **Items of welfare work.**—(i) *Education.*—The unsatisfactory position regarding the education of industrial workers has already been noticed.[2] Some enlightened employers of labour like Tatas have arranged for the education of children and adult operatives in day and night schools. The Social Service League of Bombay and the Y.M.C.A. have also done much to promote the education of the industrial workers in schools as well as by providing reading rooms and libraries. (ii) *Medical aid.*—The provision of facilities for medical attendance appears fairly general in the large and important factories in India, though it is rare to find the needs of female workers met by the appointment of special lady doctors. (iii) *Maternity benefits.*—In the interests of women workers and their children Western countries have introduced maternity benefits and prohibition of employment of women for some period before and after child-birth. The fact that women workers in India are also domestic drudges makes similar arrangements here all the more important. The Washington International Labour Conference of 1919 adopted a draft convention concerning the employment of women before and after child-birth. While India was not expected to ratify the convention immediately, the Government of India were invited to make a study of the question, including the grant of maternity benefits, and to report to the next Conference. The inquiries in connexion with the report submitted showed that such schemes had been instituted only by very few employers of labour. The reporting Provincial Governments, however, expressed their willingness to encourage the institution of further voluntary schemes. Additional inquiries made by the Government of India in June 1924 showed that, in the three big organized industries of Bengal, namely jute, tea and coal, there were several definite schemes of maternity benefits. In the tea gardens in Assam, and the Assam Railways and Trading Company, in the mines of Bihar and Orissa, in the factories of Bombay, Madras and the Central Provinces, there are a large number of these schemes in operation, under which several concessions are allowed, such as grant of leave for varying periods during pregnancy, supply of free milk and feeding bottles, etc. Over and above all this, Bombay has a growing number of maternity homes. In her final report, Dr Barnes, the woman doctor appointed by the Bombay Government in connexion with maternity benefits to women workers, gives interesting details regarding the maternity allowances granted by the Tata group of mills. Two months' wages are given as allowance (one month before and one month after confinement) to a woman worker with a

[1] *Indian Year Book*, 1940-1, p. 559.

[2] See ch. i, §9.

service of at least eleven months to her credit, on production of a certificate from a woman doctor regarding the completion of eight months of pregnancy and on her giving an undertaking not to work for a wage anywhere else.

In 1924 Mr N. M. Joshi introduced in the Assembly a Bill to regulate the employment, before and after confinement, of women in factories and mines, and on estates to which the Assam Labour and Emigration Act of 1901 applied, and to make provision for the payment of maternity benefits. It provided for the grant of leave six weeks before and after confinement and of maternity allowances by local Governments from a maternity benefit fund subscribed to by employers of labour. The Bill was rejected by the Assembly on the ground that it was too much in advance of public opinion in India. Similar legislation was, however, passed for Bombay in the form of the Bombay Maternity Act (1929). It applied in the first instance to certain selected cities in the province but could be extended to other places by the Government. The Act, as amended in 1934, prohibited the employment of a woman during four weeks immediately following the day of delivery, and made it illegal for her to work in any factory during this period. Maternity benefit at the rate of eight annas a day, for the actual period of absence not exceeding four weeks before confinement and four weeks immediately after confinement, can be claimed by a woman from her employer provided she has been employed in his factory for not less than nine months immediately preceding the date on which she notifies her intention to absent herself from work owing to approaching confinement within one month next following. If, however, she works in any factory during the period of leave granted her, she forfeits her claim to the maternity benefit. In 1938 the Act was extended to women employed in all industrial concerns in the province. A Maternity Benefit Act of limited application was also passed in the Central Provinces in 1930. The Madras Maternity Benefit Act (1935) closely follows the provisions of the Bombay Act. Except for the Assam Maternity Benefit Act, which applies to women in plantations as well as factories, all the other Acts apply only to women employed in factories. 'The main principles in all Maternity Benefit legislation are the same: provision for the payment of a cash benefit to women for specified periods before and after childbirth, a compulsory period of rest after delivery and also before delivery if notice is given. . . . All Acts specify a qualifying period for the earning of the benefit. This varies from six months to a year. Women are prohibited from accepting employment under another employer during periods for which they are in receipt of cash benefit from the employer with whom this liability rests.'[1]

(iv) *Recreation.*—The value of recreation hardly needs to be specially stressed. Anything should be welcome that adds a little colour to the life of the worker, which for the most part is set in grey. It is also most important to induce the worker to utilize his spare time so that he is kept away from the liquor shop and the bucket-shop and generally to increase the attractions of industrial work in the towns and make him less reluctant to settle down permanently at the industrial centres. In this connexion, the activities of the Social Service League, Bombay, which has organized a Working Men's Institute at Parel, and of some enlightened employers like Tatas and the Buckingham and Carnatic Mills,

[1] *The India and Pakistan Year Book*, 1949, p. 199.

Madras, deserve special mention; the Government of Bombay also deserve to be congratulated on their welfare centres. As a result of such activities provision is made for outdoor sports and indoor games, entertainments, such as cinema shows, magic lantern lectures, musical concerts, dramatic performances, wrestling matches, etc. (v) *Housing*.—This question has already been fully discussed earlier in the chapter.[1] (vi) *Co-operative societies*.—The work done by co-operative societies for industrial workers has already been alluded to in the chapter on the co-operative movement.[2] (vii) *Grain and cloth shops*.—Some mills maintain shops where cheap grain and cloth are sold to the workmen, thus preventing them from being swindled by the *bania*, though the more elastic credit given by the *bania* offers a great temptation to the workers to make their purchases from him, a tendency fostered by the degeneration of some of the mill shops into 'truck' shops. The only satisfactory solution lies in the organization of co-operative stores. (viii) *Teashops and canteens*.—There is a very meagre provision of teashops and canteens though there is an imperative need for proper facilities for obtaining good and wholesome tea and cooked food. There are only a few canteens of the type which made considerable progress in England under the stress of production during the last war. Caste difficulties and the conservatism of women have acted as great obstacles.

The most recent amendment of the Factories Act noticed above (§27) contains several provisions in connexion with welfare, for example maintenance of adequate shelters for rest, reservation of rooms for the use of children of women workers in factories employing more than fifty women, provision of first-aid appliances, etc. Not only does welfare work require to be greatly extended in India but it should also be controlled more and more by the workers themselves. At present it is largely controlled by employers, and this impinges upon trade union organization and its activities. The selection of leading workers to associate with the management of welfare committees is scarcely a satisfactory arrangement as it tends to detach them from the general body of workers.[3]

[1] §§13-15.

[2] See vol. I, ch. x, §11.

[3] See *Report on Labour Conditions in India* (British Trade Union Congress Delegation, 1928), p. 12.

CHAPTER IV

THE NATIONAL DIVIDEND

§1. **Estimates of national dividend: Dadabhai Naoroji's estimate.**—The first serious attempt to estimate the national income in India was that of Dr Dadabhai Naoroji in his well-known book, *Poverty and Un-British Rule in India.* This estimate is based on official figures relating to the years 1867-70. Dr Naoroji explains the principles he followed in these words:—'I have taken the largest one or two kinds of produce of a province to represent all its produce. I have taken the whole cultivated area of each district, the produce per acre, and the price of the produce; and simple multiplication and addition will give you both the quantity and value of the total produce. From it, also, you can get the correct average of produce per acre, and of prices for the whole produce.' Working on this basis he arrives at the figure of £277,000,000 as the value of the gross agricultural produce. From this he deducts six per cent for seed. The balance left amounts to £260,000,000. Next, £17,000,000 is taken as the value of salt, opium, coal, and profits of commerce. The value of manufactures is put down at £15,000,000. An equal amount is allowed for the annual produce of stock, fish, milk, meat, etc. and £30,000,000 is further added for any contingency. All these items add up to £340,000,000, and taking the population at 170,000,000, the *per capita* income for British India comes to 40*s*. or Rs. 20 per head. Dr Naoroji then proceeds to show on the basis of jail dietaries and rations for emigrant coolies, etc., that this is less than the Rs. 34 or so which is required for bare subsistence, and he comes to this conclusion:—'Even for such food and clothing as a criminal obtains, there is hardly enough of production even in a good season, leaving alone all little luxuries, all social and religious wants, all expenses on occasions of joy and sorrow, and any provision for a bad season. . . . . Such appears to be the condition of the masses of India. They do not get enough to provide the bare necessaries of life.'[1] 'As the balance of income every year available for the use of the people of India did not suffice for the wants of the year, the capital wealth of the country was being drawn upon, and the country went on becoming poorer and poorer and more and more weakened in its capacities of production.'

Dr V. K. R. V. Rao considers that Dr Naoroji's figures in respect of meat, milk, fish and industry are definitely underestimates. The value of the output of meat, milk and fish is about 25 per cent of the value of agricultural produce. On this basis the income from this source would be £65 million instead of £15 million. The proportion of population supported by industry is much above 6 per cent of the agricultural population and it is reasonable to suppose that the income per head of industrial workers is greater than that of the agricultural population. The income from manufactures should therefore have been put down at about £60 million rather than £15 million. A further addition is necessary in connexion with transport, public force and administration, professions and domestic servants. After all

[1] Op. cit., p. 31.

these corrections the figure for national income will be found to increase from Rs. 20 *per capita* to somewhere between Rs 23 and Rs 24.[1]

§2. National income between 1875 and 1911.—The next inquiry to be noticed after that of Dr Naoroji was undertaken in 1882 by Earl Cromer (then Major Evelyn Baring) and Sir (then Mr) David Barbour, and their results were as follows :

Agricultural income	..	Rs. 350,00,00,000
Non-agricultural income	..	Rs. 175,00,00,000
Total	..	Rs. 525,00,00,000

Divided amongst 194,539,000 people, which was the population figure at that time, the average amount per head came to Rs. 27.

We may next notice W. Digby's estimate which proceeded on the assumption that the Government land revenue bears a definite relation to the outturn, and the percentage between the total outturn and the land revenue was taken at a varying figure as arrived at by Romesh Chundra Dutt and used by him in his *Open Letters to Lord Curzon*. The percentages were as follows:

In Bengal	..	.. 5 to 6 per cent	
,, the N.-W. Provinces	..	8 ,, ,,	
,, the Punjab	..	10 ,, ,,	
,, Madras	..	.. 12 to 31 ,, ,,	say 20
,, Bombay	..	.. 20 to 33 ,, ,,	say 25

Digby's calculation yielded the following results:

Agricultural income for 1898-9	..	Rs. 285,00,00,000	£189,000,000
Non-agricultural income ,, (half above)	..	Rs. 143,00,00,000	£ 95,000,000
Total	..	Rs. 428,00,00,000	£284,000,000

Divided among 24,50,00,000 people which, according to the calculations of the Government of India, was the probable population figure, the average income would on this basis be Rs. 17-8-5. The census of 1901, however, returned only 23,10,00,000 as the total population. On this basis the *per capita* income would be Rs. 18-8-11, *in a good year*. For the famine year 1899-1900, Digby calculated it would be as low as Rs. 12-6-0.

Lord Curzon, in reply to this and other similar statements, worked out his own estimate on the basis of the figures collected for the Famine Commission of 1898, giving the latest estimate of the value of agricultural income in India, which was placed at Rs. 450,00,00,000. The calculations of 1880 had shown the average agricultural income to be Rs. 18 per head and, taking the figures of the latest census for the same area as was covered by the earlier computation, it was found that the agricultural income had increased to Rs. 20 per head. Assuming that the non-agricultural income had also increased in the same ratio, the average income would come to Rs. 30 per head in 1900 as against Rs. 27 in 1880. Lord

[1] See V. K. R. V. Rao, *India's National Income*, 1925-29, pp. 17-22.

[2] See W. Digby, *Prosperous India*, p. 366.

Curzon admitted that the data were not incontrovertible, but he pleaded that the figures of 1880 were also to a certain extent conjectural and that, if one set of figures was to be used in argument, so equally might the other. He also admitted that the advance in economic position revealed by the calculations was not in itself 'very brilliant or gratifying'. But at the same time they showed that the movement was in a forward and not backward direction.

Digby now again returned to the charge and re-examined the question in order to show that Lord Curzon's estimate erred too much on the side of optimism. As regards agricultural income he adopted the same old plan of deducing it from the land revenue. But in the case of the non-agricultural income, instead of assuming it to be half of the agricultural income, he examined a large number of items and came to the conclusion that the total income of the country was £259,000,000 which, divided among a population of 226,000,000 people, gave Rs. 17-4 as the average income per head.[1]

F. J. Atkinson wrote a paper in 1902 entitled 'A Statistical Review of the Income and Wealth of British India', which was read before the Royal Statistical Society in London. He divided the total population into three classes: (i) agricultural, (ii) non-agricultural (poorer), (iii) non-agricultural (well-to-do). The income of class (i) was calculated on the basis of statistics of area, yield and prices. The income of class (ii) was obtained by multiplying the number of different kinds of earners by wage-rates appropriate to each. For class (iii) civil estimates for Government officials and income-tax returns for the professional classes were used. On this basis Atkinson estimated that the *per capita* income was Rs. 30·5 in 1875 and Rs. 39·5 in 1895. No allowance was made for seed, wastage and depreciation. The number of those gainfully occupied as well as the period during which they were occupied was overstated, and certain extraordinary additions, such as the income of mendicants, were made. The final result was therefore a considerable overestimate and Dr Rao finds it necessary to correct Atkinson's figure of Rs. 39·5 to Rs. 31·5.[2]

§3. **Wadia and Joshi's estimate.**—P. A. Wadia and G. N. Joshi have worked out an estimate of the national income of India with reference to the year 1913-14.[3] We may briefly indicate the results of their inquiry. Agricultural production is put down at Rs. 1072,99,93,282, from which is deducted 20 per cent as the amount invested or set apart for seeds, manure, etc. This gives a net figure of Rs. 858,39,94,626. As regards mineral production the gross value is calculated at Rs. 14,40,95,000, from which 20 per cent is again deducted for depreciation in value and the working cost so far as it affects wages (mineral production having been included in the value of manufactures estimated at a later stage of the calculation). We thus get a net valuation of Rs. 11,52,76,000. Next follows the valuation of various products, such as hides and skins, manures, wool, silk, poultry products, on the assumption that exports of these products amount to 80 per cent of the total production. To this is added the value of the products of fisheries calculated at 4 annas per head for 275 days for 865,000 persons engaged in fisheries. The final

[1] Digby's estimate, like Dr Naoroji's, does not take account of the value of services.

[2] Op. cit., pp. 28-36.

[3] *The Wealth of India*, pp. 97-112.

addition is in connexion with the valuation of products worked by artisans, and earnings of labourers engaged in trade and transport, at 4 annas per head per day for 310 days for 18,000,000 persons. All this works out at a total of Rs. 154,29,58,750. The next item dealt with is the produce of livestock. The figures taken in this connexion relate to the year 1917-18 and it is assumed that the difference between the number of cattle in this year and that in 1913-14 could not be appreciable. The total annual value of all the cattle is estimated at Rs. 349,05,11,518, from which the value of the services of cattle for agricultural purposes is deducted to prevent duplicate reckoning, seeing that these services are already included in the value of agricultural production as given above. As regards the added value of manufactures, this is arrived at by taking it to be one-fifth or 20 per cent of the gross total of raw materials (Rs. 204,76,65,000). This gives the figure of Rs. 40,95,33,000. The authors proceed to make various deductions from the total gross income arrived at by the method described above, and they give the following statement showing the various sums to be deducted from the aggregate national income in 1913-14:

1. Home charges	£20,000,000
2. Investment of foreign capital on behalf of the Government	8,000,000
3. Profits on foreign capital invested in India ..	39,000,000
4. Investment of new foreign capital in India ...	5,000,000[1]
5. Remittances of money from India on private account by Government officers, European employees in banks, joint-stock companies, etc.	10,000,000
	£82,000,000
	= Rs. 123,00,00,000

The following table thus sums up the results of Wadia and Joshi's estimate.

Total Annual Income or National Dividend of British India in 1913-14

	TOTAL VALUATION (IN RUPEES)
1. Agricultural production	858,39,94,626
2. Mineral production	11,52,76,000
3. Miscellaneous products and earnings of artisans, etc.	154,29,58,750
4. Produce of livestock	145,10,34,634
5. Manufactures	40,95,33,000
Total net valuation	1,210,27,97,010
Deduct for home charges, etc.	123,00,00,000
Net annual income	1,087,27,97,010

[1] The authors of the Bowley-Robertson Report point out that the value of this item has been deducted twice instead of once.

Dividing this net income by the total population of British India, namely 245,189,716, we get as the annual income per head Rs. 44-5-6 or £2-19-1.

The population of British India according to the census of 1911 was 244,189,716. To this has been added 1,000,000 as representing the possible increase in numbers in three years.

§4. **Shah and Khambatta's estimate.**—K. T. Shah and K. J. Khambatta's estimate is summarized in the following table.[1]

Items	Pre-war period 1900-14	War and post-war period 1914-22	Whole period 1900-22	Year 1921-2
	(Crores of rupees)			
Agricultural produce	1014·8	1686·5	1257·1	2155·8
Deduct for seeds	20	35	25	58
Net agricultural produce	994·8	1651·5	1232·1	2097·8
Forest wealth	10	20	14	28
Fisheries	1·2	2·5	1·9	3·2
Manufactures	80	150	106	186
Mineral wealth	10	21·6	14	28·7
Buildings, etc.	10	16·4	12	20·3
Total	1106	1862	1380	2364

This gives the *per capita* gross income of
- Rs. 36 for 1900-14
- Rs. 58½ for 1914-22
- Rs. 44½ for 1900-22
- Rs. 74 for 1921-2

Making an adjustment with reference to the change in the level of prices, the income is stated at the pre-war average price-level as amounting to Rs. 36 per head for the pre-war period, and Rs. 38-2 for the war and the post-war periods. From the gross income the authors make a number of deductions on account of home charges, etc. and come to the conclusion that this 'drain' takes about Rs. 7 away from the *per capita* income for 1921-2, reducing it to Rs. 67. Dr Rao calculates that Rs. 7 would have to be added to this *per capita* figure in view of (i) the non-inclusion of services and of (ii) clear underestimates under the headings of 'livestock', 'manufactures and handicrafts' and 'transport and trade'.

§5. **Findlay Shirras's estimate.**—In the estimate made by G. Findlay Shirras for the years 1920-1 and 1921-2, he puts the agricultural income for the former year at Rs. 171,494 lakhs and for the latter at Rs. 198,341 lakhs, and the non-agricultural income at Rs. 883 crores. On this basis the *per capita* income comes to Rs. 107 for 1921, and Rs. 116 for 1922. Shirras points out that in all the inquiries between 1881 and 1911, it had been assumed that the gross income of agriculturists and non-agriculturists was distributed between the two classes in proportion to their numbers. This worked satisfactorily enough so long as the country was industrialized only to a small degree. But during the previous few years rapid changes had

[1] K. T. Shah and K. J. Khambatta, *The Wealth and Taxable Capacity of India*, pp. 199-200.

taken place, and some additional allowance was therefore necessary in order to arrive at the total non-agricultural income,[1] and the addition of Rs. 75 crores appeared to meet the requirements of the case, giving the total of Rs. 883 crores. One of the obvious criticisms of Shirras's estimate is that, contrary to the usual practice, he makes no deductions on account of seed in computing the agricultural income. It should further be noted that the non-agricultural income is about 40 per cent of the agricultural income in Shirras's estimate, whereas it is only about 10 per cent in Shah and Khambatta's estimate and about 30 per cent in that of Wadia and Joshi. This disparity is due, among other things, to the difference in the treatment of the service utilities. Shah and Khambatta exclude the services from their computation, whereas Shirras includes them.

§6. **V. K. R. V. Rao's estimate.**—Dr V. K. R. V. Rao has made an estimate for the year 1931-2. According to him, the net income of British India in the year 1931-2 was between Rs. 16,000 millions and Rs. 18,000 millions or a *per capita* income of Rs. 65 with a margin of error of + or — 6 per cent. The details are given below :

Description	Value in millions of rupees	Margin of error, percentage
Value of Agricultural output	5,927	—
Value of Livestock products	2,683	± 10
Value of Fishing and Hunting	120	± 20
Value of Forest products	92	—
Value of Mineral produce	180	—
Incomes assessed to income-tax	2,161	—
Incomes not assessed to income-tax of workers engaged in industry	2,100	± 17
Incomes not assessed to income-tax of workers engaged in service of the State, Railways, Posts and Telegraphs ..	590	—
Incomes not assessed to income-tax of workers engaged in Trade	1,233	± 15
Incomes not assessed to income-tax of workers engaged in Professions and Liberal Arts	416	± 15
Incomes not assessed to income-tax of workers engaged in Transport other than Railways, Posts and Telegraphs ..	283	± 20
Incomes not assessed to income-tax of workers engaged in Domestic Services	325	± 20
Miscellaneous items	780	± 10
Total ..	16,890	± 6

Dr Rao claims greater accuracy for his as compared to previous estimates on the ground that he has supplemented the available statistical material by a number of *ad hoc* inquiries in respect of 'output of meat and milk, incomes of persons engaged in industry, service of local authorities, domestic service, etc.'[2]

§7. **The Eastern Economist's estimate.** In its Annual Number (31 December 1948) the *Eastern Economist* gave the following figures for national income from 1939-40 to 1947-8.

[1] *The Science of Public Finance* (second edition), pp. 138-45.
[2] *The National Income of British India*, 1931-32, p. 4 and pp. 185-6.

NATIONAL INCOME OF BRITISH INDIA FROM 1939-40 TO 1947-8

(In millions of rupees)

	1939-40	1940-1	1941-2	1942-3	1943-4	1944-5	1945-6	1946-7	1947-8 (India only)
Income from agriculture & allied occupations ..	9,527	10,395	11,048	17,402	21,281	22,938	22,245	25,692	21,293
Income from industry ..	3,790	4,062	6,020	9,560	12,400	11,120	10,338	9,382	9,800
Other items ..	6,026	6,126	6,292	6,772	8,651	8,651	9,799	9,798	8,328
Total income ..	19,343	20,583	23,360	33,734	42,332	42,709	42,382	44,872	39,421

The following table shows the position as regards changes in *real income* as distinguished from *money income*, the adjustment being made with the help of the Bombay Cost of Living index :

Per Capita INCOME OF PROVINCES—INDIA AND PAKISTAN

	1939-40	1940-1	1941-2	1942-3	1943-4	1944-5	1945-6	1946-7	1947-8 (India only)
Total income (in millions of rupees) ..	19,343	20,583	23,360	33,734	42,332	42,709	42,382	44,872	39,421
Population (in millions) ..	290	294	298	302	305	306·5	310	314	246
Per capita income (rupees)	67	70	78	112	139	139	137	143	160
Cost of living index, Bombay (base 1939-40=100) ..	100	105	117	160	217	216	219	242	258
Income adjusted with cost of living (Bombay index) ..	67	67	66	70	64	64	63	59	62

The above figures show a decrease of the *per capita* (real) income from Rs. 67 in 1939-40 to Rs. 62 in 1947-8. Moreover, part of this income was utilized not in consumption but in building up the sterling balances. This is reflected in the following figures showing reduced consumption of food and clothing.

FOOD AND CLOTHING—CONSUMPTION PER HEAD

	1939-40	1940-1	1941-2	1942-3	1943-4	1944-5	1945-6	1946-7	1947-8
Food consumption per head (in lb.)	388	366	348	378	379	370	340	358	357
Cloth consumption per head (in yd.)	16	16	14	10	14	14	12	12	11

§8. **Difficulties of interpretation and comparison.**—In comparing these results the reader must bear in mind several cautions. The first is that they relate to different dates and the difference in prices at the two dates must be taken into account.

Thus, Rs. 45 in 1913-14 would be equivalent to Rs. 81 in 1921-2 on the assumption of an 80 per cent rise of prices. Another fact to be remembered is that the area covered by the computations is not in every case the same. For instance, Shah and Khambatta included not only British India but also the Indian States, so that if a comparison is to be instituted between their estimate and one which is limited to British India, we should probably have to raise the *per capita* figure of Shah and Khambatta somewhat, assuming that British India is slightly richer and economically more advanced than the Indian States taken as a whole. We must further allow for the difference in the methods adopted in the inquiries. We have already seen, for example, that Shirras does not make any deductions, whereas the other estimates make them to a smaller or greater extent. Again, we must remember that there is a difference of treatment arising from divergent views as to the constituent elements in the national dividend. As we have seen above, Shirras's estimate includes the incomes of the professional classes,[1] while they are deliberately excluded in some of the other estimates. In order to institute profitable comparisons between the results of inquiries relating to two different periods, we must not take the actual figures as they are given, but as they would have been if the methods adopted had been identical. Another point to notice is that, generally speaking, the later valuations are on a more scientific basis; as Shirras points out, if the old methods were followed in preference to his more elaborate method, the values of agricultural produce and non-agricultural income in his estimates would be appreciably lower.

Care is also necessary in drawing inferences about economic welfare from the *per capita* income. Here it is important to consider not only the average income per head but also the composition of the national income. In the case of India, for instance, an inquiry as to how much of the national income is in the form of foodstuffs would be specially pertinent. For, if the supply of an absolute necessary of life is disclosed to be insufficient, additions to the national income in other forms cannot be regarded as of the same order of importance as foodstuffs. Again, if services were to be included in the computation, the semi-political question whether some of the services were not overvalued in India could not be ignored during the period of our political dependence.

Lastly, in considering the result of any particular inquiry we must take into account the spirit and purpose underlying it. Most of the investigations referred to above have been admittedly informed by a spirit of political controversy. Not infrequently we find the course of the investigation interrupted by roadside notices that the particular valuation is a deliberate underestimate or overestimate, as the case may be. The curious thing, however, is that the pretended underestimates almost invariably give us a higher figure than the pretended overestimates, because liberal concessions granted to rival disputants 'for the sake of argument' in one direction are more than compensated by quietly taking liberties elsewhere, the effect of which is to swing the pendulum violently in the opposite direction.

Sometimes, however, the picture of extreme poverty gets overdrawn by people

[1] Shirras does not explicitly include services in his main estimate, but he checks his figures for non-agricultural income by a table in which the valuation of services is included.

arguing as if the *per capita* income were the income of an average family. We should be making the opposite mistake of supposing that the condition of the masses is better than it really is if we did not remember that the national income is very unevenly distributed. Some people enjoy very much more than the average income and some very much less. The learned professions and the bigger landowners, for instance, enjoy a very much higher income than the cultivators or industrial labourers. The petty traders and shopkeepers have incomes of a medium size. Among the *urban classes* probably half of the total income belongs to one-tenth of the people. Among those with incomes exceeding Rs. 2,000 a year, 38 per cent have only 17 per cent of the total income, while about 1 per cent possess 10 per cent of the total income. The inequality of distribution is equally evident among the *agricultural classes*, and is indicated, among other things, by the distribution of agricultural holdings. For instance in Bombay, out of 22 lakhs of registered holders of land, 10 lakhs have each a holding below 5 acres in size, i.e. 48 per cent of the landholders possess only 9 per cent of the cultivated land, while 1 per cent of the landholders possess 16 per cent of the total land. There is also the large class of landless agricultural labourers whose economic position is definitely lower than that of the holders of land.[1]

According to Shah and Khambatta more than a third of the wealth of the country is enjoyed by about 1 per cent of the population, or, allowing for the dependants, about 5 per cent at most; that slightly more than another third, about 35 per cent, of the annual wealth produced in the country is absorbed by another third of the population, allowing for the dependants; while 60 per cent of the people of erstwhile 'British' India enjoy among them about 30 per cent of the total wealth produced in the country. There are grounds for believing that since 1939 there has been an unmistakable shift of national income from secondary and tertiary sectors to the primary sector mainly consisting of agriculturists; also that since 1939 labour has secured an increase in real as well as money earnings in organized industries although the real earnings in these industries have dropped by about 13 per cent owing to a fall in labour's productivity partly caused by shorter working hours and partly by deterioration in capital equipment. Real profits appear to have declined since 1943.[2]

It should also be remembered that the *per capita* income varies from province to province.[3] It would be larger in those provinces which grow commercial crops and which are relatively more industrialized, such as Bombay, Bihar, the Central Provinces and Berar, whereas Orissa, the United Provinces and Madras are relatively poorer provinces.

§9. **International comparisons.**—International comparisons cannot be based merely on a consideration of the *per capita* income of the countries under comparison. Sir Robert Giffen drew attention to the dangers of making these comparisons without introducing the necessary qualifications and of assuming 'that figures called by the same names in different countries have exactly the same values'. Figures of the income per head do not tell us much about the economic

[1] Rao, *The National Income of British India*, 1931-32, p. 189.
[2] See *The Eastern Economist*, Annual Number 1948, pp. 1123-9.
[3] See Vakil and Muranjan, op. cit., pp. 356-7.

well-being of the people of one country as compared to people belonging to another, unless we allow for such factors as differences in standards of living, habits and customs. As Sir Josiah Stamp points out: 'In the countries to be compared, men must care for the same objects in a similar way, and their scale of relative values must be akin. To the extent to which countries diverge in this respect, the comparison will be invalid.'[1] The same income per head, for example, would obviously have an entirely different significance in two countries so wide apart from each other as India and England, because the scale of values is different, not only owing to difference in taste but also because external conditions impose different standards of requirements. Broadly speaking, owing to the warmer climate of India, an appreciably smaller expenditure is required on food, clothing, fuel and housing than in England. We must also not lose sight of the fact that 'a great part of the population of India is little concerned with a money economy, since it lives on local produce that never passes through a market'. However, when every allowance is made for these factors, the fact remains that India is an incomparably poorer country when considered side by side with the countries of Western Europe and particularly with the United States. For purposes of comparison we do not seem to come within the same 'universe of discourse' except when we leave the more progressive countries alone and seek comparison with some of the backward countries of Eastern Europe like Bulgaria, or with Soviet Russia in the throes of transformation.

§10. **Intensive inquiries.**—Besides intensive village and regional inquiries made by individual investigators, such as Dr Mann in Bombay and Dr Slater in Madras, a number of surveys have been conducted under the auspices of the Rural and Urban Sections of the Punjab Board of Economic Inquiry. Some years ago the Indian Central Cotton Committee carried out eight investigations into the finance and marketing of cultivators' cotton, which were the first intensive inquiries of the sort recommended by the Indian Economic Inquiry Committee and which contain information of the utmost importance.[2] All these investigations generally corroborate the conclusions stated above about the economic condition of the people.

§11. **Is Indian poverty on the decline?**—Granting the existence of appalling poverty as an indisputable fact, the question whether it is increasing or diminishing, or whether there is no movement either way, has been variously answered. Wadia and Joshi hold that, during the twenty years between 1895 and 1914, the condition of the population did not undergo any change. The more common view, however, is that there was a real, if very slow, amelioration of the condition of the people and that this progress has on the whole been maintained. That the

[1] cf.'It is very doubtful whether numerical comparison can be safely made between two countries; neither housing, clothing nor food are comparable. The importance of that part of income which is not wages varies greatly, and many things must be bought in one country which are unnecessary or are home-made, home-grown, or obtained freely in another. Nor should we compare industrial classes, such as workmen engaged in building, engineering or printing, in different countries, since methods and conditions of work vary enormously, unless we make very broad allowances for the possible effects of such variation.'—A. L. Bowley, *The Nature and Purpose of the Measurement of Social Phenomena*, quoted in *Economic Inquiry Committee Report*, p. 117.

[2] See *General Report on Eight Investigations into Finance and Marketing of Cultivators' Cotton*, 1928.

people are getting more and more discontented is true, but as European experience shows, this is quite compatible with a great betterment in the economic position of the masses. With increasing wealth there generally comes an increase in the consciousness of poverty. A people may be so brutalized by extreme poverty as to lose all consciousness of it. But a little relief from poverty is commonly followed by a desire for still further relief. Modern economic advance has been accompanied by a great multiplication of human wants and the modes of satisfying them, so that poverty has come to mean not so much the inability to satisfy a few primal wants as the inability to share in the new known goods of each period. Although the masses are better fed, better clothed, and better housed today in Western countries than fifty years ago, they are more discontented with their state than ever before. According to some observers, a similar change has come over the spirit of the people in India, and this is one of the results of a decided improvement in their economic condition. The various estimates of national income we have set out above, in spite of their imperfections, do, on the whole, succeed in conveying an impression of gradual improvement. This impression is strengthened by such admitted tendencies as the growing independence of spirit displayed by agricultural as well as industrial labour. Also, before the war of 1939-45 there were on the whole good grounds for inferring that the *per capita* consumption of food as well as of cloth was gradually increasing. The official view in this country was that the amelioration was unquestionable, and the reasons advanced in support of it are well exemplified in the following quotation: 'So far as ordinary tests can be applied, the average Indian landholder, trader, ryot, or handicraftsman is better off than he was fifty years ago. He consumes more salt, more sugar, more tobacco, and far more imported luxuries and conveniences than he did a generation back. Where house-to-house inquiries have been made, it has been found that the average villager eats more food and has a better house than his father, that, to a considerable extent, brass and other metal vessels have taken the place of the coarse earthenware vessels of earlier times, and that his family possesses more clothes than formerly.'[1] The truth of this picture was challenged by non-official observers and some of its details especially were regarded as open to doubt. For example, the statement that the average villager ate more food was not universally accepted. Among other things it was pointed out that in the villages, especially in those in the vicinity of towns, the dietary of the average villager had deteriorated and he was worse nourished than before. The average consumption of milk products, which occupy such an important position in a predominantly vegetarian diet, had distinctly fallen off, and no substitute which could be regarded as of equal nutritional value had taken its place. But even assuming that there was some increase in the wealth of the country it cannot be compared for a moment with the amazing advance achieved by Western countries like England in recent times—an advance reflected in the reduction of pauperism, decrease of death-rate and poverty diseases, increase of wages, shortening hours of labour, spread and improvement of education, increase in the means of recreation, better housing and sanitation, etc. There

[1] *Results of Indian Administration in the Past Fifty Years*, Cd. 4956, 1909, p. 26, quoted by L. C. A. Knowles in *The Economic Development of the British Overseas Empire, 1763-1914*, vol. I, p. 275.

are indeed great inequalities in the distribution of wealth in the West, but there can be no question about the wide diffusion of economic well-being. The cheapness and plenty of the good things of life together with the universal rise of incomes have brought within the reach of the masses many commodities and modes of enjoyment which were formerly the monopolies of the very rich and have resulted in what Vicomte D'Avenel calls '*le nivellement des jouissances*' (the levelling-up of enjoyments).[1] It appears that the real national income per head of 'British India' rose by about 4·5 per cent between 1939 and 1943 but that subsequently the position has steadily deteriorated.[2] Mr K. C. Neogy, Finance Minister, said in the Dominion Parliament on 20 August 1949, that according to an estimate made by the Ministry of Commerce the income per head for undivided India was Rs. 198 in 1945-6. If 'provinces' of the Indian Dominion alone were considered, this figure would increase to Rs. 204. Corresponding figures for other countries were: Australia, Rs. 1,799; Canada Rs. 2,868; United Kingdom, Rs. 2,355; U.S.A. Rs. 4,868.

§12. **Need for better statistics.**—In pronouncing judgements on the various problems concerning the economic condition of the people in India it is found that nothing more than a halting, uncertain attitude is possible owing to lack of precise statistical information. On everything else besides the obvious fact of extreme poverty we are left almost completely in the dark. The collection of reliable statistical data will make our information more precise and minimize the large number of conjectural assumptions which are now unavoidable in every inquiry. It will also make possible a correct diagnosis of the numerous economic and social ills from which the country is suffering, and will be of great assistance in tackling the day-to-day problems of administration. The Indian Economic Inquiry Committee (1925) quote the following apposite remarks of *The Times* (London) in this connexion. Speaking of the Empire Statistics Conference, which sat in January and February 1921, it said: 'In Germany before the war the Statistical Bureaux were ceaselessly employed in working on everything that illuminated the future of the German people; and in the era which is now opening there can be little doubt that the nation which studies the drift of events as it is revealed by statistical analysis will be infinitely better equipped to take advantage of its opportunities than another which perhaps trusts only to the methods of empiricism.'[3] The statistics at present collected are often un-coordinated and without expert direction and are generally a by-product of administration meant more for departmental use than for the purpose of affording information to the public about important social and economic activities.

It is indeed true that in India the collection of statistics is attended with extraordinary difficulties. In the first place, the huge size of the country makes the enterprise expensive and difficult to carry out. Secondly, the population is scattered in rural areas and not concentrated in big cities and towns. Thirdly, the existence of illiteracy makes the co-operation of the public in the work of gathering statistical data a practical impossibility. In Great Britain and the other Domi-

[1] *Découvertes d'Histoire Sociale*, pp. 295-318.
[2] *Eastern Economist*, Annual Number 1948, p. 1148.
[3] *Economic Inquiry Committee Report*, p. 4.

nions, the statistics of production, wages and prices are usually collected by distributing schedules to private individuals who are required to fill them up within a given time and return them. This is a more accurate as well as a less expensive method than that of engaging a specially paid staff. Much assistance is also derived from the co-operation of a number of private associations, the like of which are almost entirely absent in India. Absence of organized enterprise and the existence of numerous small unorganized undertakings further make statistical work extraordinarily difficult.[1] However, although we cannot hope immediately to attain to the standard of equipment usual in Western countries, there can be no doubt that the present position in this regard in India admits of very considerable improvement.

§13. **The Bowley-Robertson inquiry.**—In November 1933 the Government of India engaged the services of Professor A. L. Bowley of the London School of Economics and Mr D. H. Robertson, Lecturer in Economics at Cambridge, to advise them on the question of obtaining more accurate and detailed statistics and the practicability of carrying out a Census of Production. Associated with these two experts were three Indian economists, and the combined labours of these gentlemen resulted in a valuable Report published in 1934 entitled *A Scheme for an Economic Census of India* of which the following is a brief summary.

§14. (i) **Organization of statistics.**—A permanent economic staff, directly attached to the Economic Committee of the Central Executive Council, should be established. The staff should consist of four members. The senior member should act as secretary to the Economic Committee of the Council, to whom he would be responsible for the organization of the whole work of economic intelligence. Thus he would have the duty of preparing reports on urgent questions as they arose from time to time, and for this purpose would need to organize the supply of current information on economic and commercial events abroad as well as at home. But it would also be his duty to be thinking further ahead, and to take the initiative in planning inquiries of a broader and more fundamental kind. Two of the other members of the staff would be trained economists, while the third would be the Director of Statistics. As far as possible the staff would function as a staff and not as individuals, but the senior member and the two economic intelligence officers would divide the territory for exploration between them in accordance with their respective bents and capacities. It would be natural, for instance, that one of them should specialize in the study of the means of regulating India's foreign trade, and the operation of tariffs and trade agreements. The two economic intelligence officers should work under conditions of the greatest freedom which is compatible with membership of a civil service. The whole staff would maintain the closest possible contact with certain other officers of the Government. It would be within their competence to recommend to the Economic Committee of the Council the *ad hoc* engagement of external technical experts for the purpose of reporting on the economic potentialities of particular areas or of particular branches or processes of production. The Director of Statistics, while being a member of,

[1] See Professor Burnett Hurst's Note of Dissent, *Economic Inquiry Committee Report*, pp. 91-2.

and the principal organ of information for, the permanent economic staff, should have the following special duties: (*a*) the conduct of the population census, (*b*) the conduct of the census of production, (*c*) the co-ordination of central statistics, and (*d*) the co-ordination of provincial statistics. To assist him in these duties the Statistics Branch of the Department of Commercial Intelligence and Statistics would be transferred to his control with some addition to its permanent members. The Commercial Intelligence Branch of this Department, which is mainly engaged in dealing with the inquiries of the commercial world, would become a branch of the Department of Commerce.

The census of production should be quinquennial; and while the main census of population continues to be decennial, a supplementary census with an abbreviated schedule of inquiries, mainly devoted to numbers, age, sex and occupation, should be taken in the middle of the decennium. The censuses of population and production should be as nearly synchronous as the requirements of tabulation permit. Preparation for the census and analysis of their results would provide nearly continuous work for a special section of the permanent statistical staff, which would expand into a larger organization on the occasion of the taking of the decennial population census. The Director of Statistics should have power to consult with those responsible for the preparation of statistics in all departments, with a view to arranging for uniformity of classification, and for the furnishing of statistics needed for general purposes, without prejudice to the assembling of other data necessary for departmental use. He should be responsible for the publication of the Statistical Abstract. There should be in each major province a whole-time statistician, as nearly independent of departmental control as administrative requirements permit, but making his services available to all departments, passing all their statistics under his review, conducting the population census under the direction of the central Director of Statistics, and co-operating with the latter in every possible way.

§15. (ii) **The measurement of national income.**—The authors of the Report remark that the materials at present available for estimating the national income and wealth of India are very defective, that the various estimates attempted so far are in any case out of date and that the problem now requires to be approached afresh *ab initio*.

The national income is the money measure of the aggregate of goods and services accruing to the inhabitants of a country during a year, including net increments to, or excluding net decrements from, their individual or collective wealth. It is probably best to ignore catastrophic decrements of wealth, such as might be caused by an earthquake or a severe epidemic of cattle plague.

As is well known, there are two methods of calculation, the first consisting in an evaluation of the goods and services accruing, the second in a summation of individual incomes. The two methods do not furnish a check on one another over the whole field; thus the services of Cabinet Ministers must be held to be worth the amount of their salaries, since there is no other way of evaluating them. In the case of India it seems unlikely that the first (census-of-production) method will ever be applicable over the whole even of the industrial field; and special caution in combining the results of the two methods may be necessary.

The first (census-of-production) method involves

(*a*) evaluating the net output of the various branches of 'productive' enterprises, agriculture, mining, industry, etc., at the point of production, being careful to avoid double counting.

(*b*) adding the value added to home-produced goods and to imports by transporting and merchanting agencies in the country.

(*c*) adding excises on home-produced goods.

(*d*) deducting the value of exports (f. o. b.), including gold and silver.

(*e*) adding the value of imports (c. i. f.), including gold and silver.

(*f*) adding customs duties on imports.

(*g*) deducting the value of goods, whether home-produced or imported, which are used for the purposes of maintaining fixed capital, or stocks of raw and finishing goods intact.

(*h*) adding the value of personal services of all kinds.

(*i*) adding the annual rental value of houses, whether rented or lived in by the owners.

(*j*) adding the increments in the holdings of balances and securities abroad, whether by individuals or the Government, or deducting the decrement in such holdings: and/or deducting the increment in the holdings of balances and securities in the country by residents abroad, or adding the decrement of such holdings.

Some of these processes call for further comment.

(*a*) That part of the product of agriculture, etc.—in India very large—which is consumed by the producer or bartered locally for services should be valued, like the rest of the outturn, at its price at the point of production, not at the retail price which consumers in distant markets pay, and which includes costs of handling, etc., which are not incurred on the home-consumed outturn.

(*c*), (*f*) This is necessary, because the total we are in search of is the aggregate of exchange-values *to the consumer*.

(*d*), (*e*), (*j*) It is easily seen that if the Government of India raise a loan in London for railway construction, the securities imported form part of the real income of the English investors, just as an import of Indian tea would do. The reverse side of the same truth is that the increment of capital wealth in India, which is included in the evaluation of production or of imports, is balanced by a capital liability to foreigners, and must be deducted to arrive at the net income. The same considerations apply to changes in the ownership of bank balances, at home and abroad, and—in the case of India very important—to increases or decreases in the stock of precious metals, which for this purpose may be visualized as foreign securities.

(*h*) (1) In what follows it will be assumed for simplicity that the services of *all* Government servants confer direct utility and form part of the real national income: deductions can be made to taste by those who please. These services should be valued at a sum which includes the pension rights accruing during the year to those who render them. (2) In India the distinction between charitable gifts, which are not part of income, and the payment for services of a customary or religious nature is peculiarly indefinite; and the line drawn is bound to be somewhat arbitrary.

The census-of-production method above described is the more fundamental of the two methods of evaluating the national income. In order that the results of the second (census-of-incomes) method may tally with it, certain precautions in following this second method must be observed.

(*a*) All self-consumed produce and receipts in kind must be included in the individual's income, valued at their selling value at the point of production. So must the annual value of houses lived in by the owners.

(*b*) All interest payments, even on loans incurred for consumption purposes, must be deducted before entering the individual's income.

(*c*) Apart from this, the incomes of all individuals in the country, including interest on Government loans and pensions of ex-Government servants, should be entered gross, that is before payment of direct taxation (including land revenue). The incomes of Government servants should be entered inclusive of pension rights accruing during the year. To the total so reached should be added the undistributed profits of companies and the net profits of Government enterprises. From the total so reached should be deducted the sum required to pay the interest on Government loans other than for productive enterprises, and the pensions of ex-Government servants, whether due at home or abroad.

(*d*) Rather oddly, receipts from customs and excise, stamp duties and local rates—that is all taxes which are of the nature of business costs—must be added to the total so far reached, for the latter is the aggregate of exchange-values accruing to producers, while the true national income, as calculated on the census-of-production method, is the aggregate of exchange-values accruing to consumers. Unless therefore this addition is made, discrepancy will arise.

The suggestions which are made below relate to the estimate of the broader sections of the national income; the various adjustments indicated above would have their place in a final calculation.

The authors do not recommend at present any estimate of national wealth as a whole. There are two methods followed elsewhere, neither of which is appropriate to India. The first is to capitalize the yield of all income-bearing property, including goodwill, assigning appropriate numbers of years' purchase to the rent of land and houses, dividends, interest, etc. and sometimes to add estimates of property publicly owned such as docks, railways, Government buildings, etc. The second is to use the statistics of property passing at death, obtained at probate, etc., and with the help of life tables to deduce the total value of property. This procedure is impossible in India since there are virtually no taxes on inheritance. As regards the first method there is certainly not enough information for the valuation of most of the important classes of individual property; and though the value of railways could be estimated, that of roads, of some irrigation works and of many other results of public expenditure defies measurement.

Though they cannot expect to measure, with any precision that would justify the attempt, the *total* wealth, it may be possible to give some indications of its *change*, by series of estimates relating to public expenditure on permanent work, to investment of new capital and to other expenditure of the nature of capital outlay.

The investigation proposed for the purpose of estimating the national income is primarily on the basis of production, but as in similar estimates in all countries a

minor part depends on individual incomes. In India the proportion to be thus estimated is probably greater in the towns, but much smaller in the aggregate than in Western countries. Partly owing to difference in the nature of the products and partly because different methods of investigation are necessary, rural income is distinguished from urban income.

For rural income they advocate an estimate of the quantity and value of all produce and services arising from the land or rendered in the villages, by the method of intensive surveys in selected villages.

For urban income they recommend in the first instance surveys of the larger towns on the method which has been successfully followed elsewhere. This is based on a sample inquiry of the personnel and occupations of families, and an estimate of their incomes partly by personal statements, partly by investigation of wages and salaries current in the towns. For incomes over the amount exempted, income-tax statistics can afford valuable help.

They have recommended also an intermediate urban population census. These three inquiries would be supplemented by a census of production applied to factories using power, mines and some other industries. This would to a considerable extent overlap the urban survey and to a less extent the rural survey. But it is of considerable importance in itself and is calculated to furnish a more accurate account of part of the whole field than the other surveys. It is believed that when all the materials are assembled, means can be found to eliminate duplication by estimating the part of the income included both in the urban or rural surveys and the census of production, or by other methods.

It would remain to estimate, on the basis of population and of the results of the main surveys, the income of the smaller towns. Additional estimates may be needed for the tea plantations and any other special areas not included in the rural survey.

These proposals will result in fairly precise estimates for large and definite sections of the income of the country's population and of its produce. When these are established, effort will be necessary to diminish the region of guess-work and to increase that of ascertained fact.

§16. (iii) **Census of production.**—The census of production would be imposed (as in Great Britain) by a special Act of the Central Legislature, making communication of the facts demanded compulsory. It appears to be necessary to limit its scope, so far as English and American methods are followed, to the larger establishments; and the natural line which suggests itself is that drawn in the Factory Act, namely the employment of twenty or more persons combined with the use of mechanical power. It would not seem desirable to extend it automatically to those smaller establishments to which, for special reasons of no great statistical significance, provincial Governments have used their powers of extending the Factory Act. But on the one hand there may be *some* classes of small workshop to which the census could advantageously be extended, while on the other there are certainly some large non-mechanical establishments, for example in building and constructing, brick-making and carpet manufacture, which ought to be brought within its scope. So also should the railways and all establishments under the Mines Act.

Although the number of operatives employed in factories forms only a small proportion of persons engaged in industry, this group is of special importance in relation to export, and for this and other reasons quite properly special attention has been given and should continue to be given to its study. It is to be remembered, however, that the progress of factory industry is to some extent at the expense of cottage industry, and it is of the greatest importance to bring the two into statistical relation to each other. There is also a possibility of tabulating the census material relating to occupations in such a way as to show the whole numbers engaged in such occupations, so that when used in conjunction with the factory statistics some idea of the relative importance of the two organizations of industry could be obtained.

A rural survey.—It is desirable, as part of the survey of Indian income and resources, to obtain information in numerical form of the income (in cash or kind) derived from the land, and its distribution among owners, occupiers, labourers, etc., together with other items of village income.

It is impracticable to make direct investigation into the circumstances of each of the half-million villages in 'British' India in any reasonably short time, even if the expense could be met or a sufficient number of investigators found. It is, therefore, necessary to proceed by sampling.

Although financial exigencies do not permit immediate effect being given to all these recommendations which, it is estimated, will cost Rs. 30,00,000, it may be hoped that it will be possible in the near future to carry out a census of production, which is essential for formulating correct economic policies.

§17. Some errors of consumption as aggravating causes of Indian poverty. Whatever tends to reduce the productivity of the people must be regarded as a cause of poverty. But besides low production unwise consumption may also act as a drag on economic progress. Intelligent consumption or 'rational destruction of utilities' requires 'reflection, intelligence and imagination'.[1] Apart from the economic ruin which extravagant expenditure may bring on the possessors of great wealth, senseless expenditure on such luxuries as do not add to the fullness and richness of life is also injurious to the community, because it diverts so much capital and labour from the production of necessaries. Nor are the rich alone guilty of harmful extravagance. In most countries the poorest classes are, by reason of their very poverty, the most reckless and extravagant. The opposite vice of niggardliness masquerading as thrift characterizes some sections of the people, particularly members of the middle classes, and certain communities like the *marwaris*, who often stint themselves and save where they ought to spend freely. It has been observed that regard for 'a fuller life in the present for the earner and a greater tendency to leave the succeeding generation, provided that it is well trained and equipped with personal capital, to look to its own welfare, [is] replacing the older view, which inculcated a slow accumulation of savings in order that the children might start

[1] cf. 'To spend money well is a harder task than to earn money well. In earning, the task is generally prescribed, but in spending, the spender takes the initiative. It is no longer passive obedience, but a good will that is required.'—J. S. Nicholson, *Principles of Political Economy*, Vol. III. p. 436.

with a better equipment of material capital'.[1] This attitude is partly due to a real change in the psychology of the people; but it is probably also due to some extent to the great rise in prices which took place after 1919. The incomes of the middle classes did not rise in proportion to the rise in prices, and consequently the savings that they might have been able to make with economy and self-denial ceased to appear worth while owing to the reduced purchasing power of money. Indications are not wanting that a similar change, though on a smaller scale, is taking place in India in the attitude of the middle classes. To some extent, this change ought to be welcome because real thrift often consists not in saving money but in spending it on an increase of well-being in the present, so as to make it promote well-being in the future. The unduly timid frugalities of some people and the reckless improvidence of others are alike censurable as impairing the economic strength of the nation.

It is not possible here to deal with the problem of consumption in India in all its aspects. There is however, no doubt about the general truth of the contention that the evil of poverty in India, though mainly due to low production, is further aggravated by ill-regulated consumption, and we propose to dwell here more particularly on one form of unwise consumption which has recently excited much attention. It is scarcely necessary to point out that there is a vital relation between physical efficiency and diet. As the German proverb has it, 'A man is what he eats' (*Man ist was er isst*). The dietary adopted by people in most of the provinces in India has so far been controlled by local circumstances and depended on the kind of food that can be grown on the spot. It is also limited by various kinds of religious prejudices and general ignorance. The consequence of this has been that the staple food of the people in some of the provinces is lacking in important nutrient substances. The differences in the physical efficiency of Indian races, such as the Sikhs, the Marathas, the Kanarese, the Bengalis and the Madrasis may be chiefly attributed to the differences in their staple diet, and have now been 'definitely correlated with differences in the biological value of foods which necessity, habit, or religious prejudice has forced them to use'. The researches of Lt-Col. R. McCarrison and others in malnutrition as a cause of physical inefficiency and ill-health are very instructive and have shown the relative nutritional values of the national diets in India. They point out that rice, which is the chief food of many people in India, especially in Madras and Bengal, is fundamentally a poor diet, deficient in important organic salts, and one which does not furnish the undefined constituents of food called vitamins, whose importance has been revealed by modern investigations. The wheat- and meat-eating people like the Sikhs, Pathans and Gurkhas have a much better physique than the rice-eating Bengalis and Madrasis. The addition of wheat, milk, butter, meat, etc. greatly improves the rice-eater's diet, as in the case of the Marathas who take principally millets, such as *jawar* and *bajra*, and sometimes wheat and also milk. The daily use of unsuitable food insidiously undermines the constitution and this is a matter of far greater importance than is commonly realized. The problem of malnutrition is distinct from the problem of poverty, because diet is not simply a matter of securing an adequate quantity of food, but of achieving a correct balance of the constituents for the

[1] W. H. Coates on the 'Report of the Committee on National Debt and Taxation', *Journal of the Royal Statistical Society* (1927), Vol. XC, Part II, p. 356.

maintenance of health and vigour. As the Agricultural Commission point out, malnutrition and starvation are not the same. 'Actually, a person suffering from malnutrition may be consuming more than his system can utilize, and more than he would normally consume if the diet were properly constituted. Deficiency diseases result from the absence of some essential elements in the diet. Their occurrence is, therefore, no indication of poverty,[1] and consequent scarcity of food. A dietary conducing to malnutrition may cost more than a well-balanced dietary which promotes health.'[2]

Widespread propaganda on the basis of authoritative investigations ought to be useful in enlightening people as to how better value could be got from properly selected food in terms of physical well-being without involving additional expenditure. The 'Eastern drowsiness' and listlessness which characterize the Indian labourer are often largely due to the factor of food, which is not only insufficient but also unbalanced, and it is with the latter aspect that we are just now concerned. In 1915 investigations into the jail dietaries of Bengal and the United Provinces were made by Colonel McCay, which showed that diet is an all-important factor, influencing physical development and the general well-being of the people. He considered that the inferior physique and vigour of the Bengali was most probably due to deficiency of protein in his diet, 'while the inclusion of wheat in gradually increasing proportions as one passes north from Bihar and Orissa and the United Provinces to the Punjab, has led to a marked physical change in the population'.[3] The improvement in communications and transport ought to help in remedying the deficiencies in the diet of a particular province by the importation of the requisite foodstuffs from other provinces. All this, however, assumes a change in the nature of the demand for foodstuffs on the part of the people concerned, and this is a question of education and enlightenment on dietetic matters. One of the measures suggested by the Agricultural Commission for bringing about an improvement in the general health of the people is the development and conservation of the fish resources of the country—a task in which they invite the Government, Local Boards and the rural community in general to parti-

[1] Dr Slater calls attention to the fact that 'in some respects the rise in the standard of living has brought physical disadvantage. Thus, for example, rice-mills have multiplied, saving housewives the laborious toil—but perhaps healthful exercise—of husking the paddy by pounding; but also robbing the rice of much of its nutritive value, the vitamins in the outermost layer of the grain being removed with the husk by the machinery.'—Introductory note to Pillai, *Economic Conditions in India*, p. xiv.

[2] *Agricultural Commission Report*, pp. 494-5. It must however be admitted that an improvement in the economic position of the people would result in their choosing a diet which is appreciably more satisfactory than at present from the nutritional point of view but which is not adopted because it is more expensive than they can afford. According to W. R. Aykroyd, the cost of a well-balanced diet was in pre-war days 'between Rs. 4 and Rs. 6 per adult per month or between Rs. 16 and Rs. 24 for a family containing the equivalent of four adult males. The cost of an ill-balanced diet, sufficient in quantity but defective in quality, was about Rs. 10 monthly. Comparison of these figures with actual pre-war income-levels in India indicates the gulf between possible and desirable expenditure on food on the part of a large section of the population.' See D. Ghosh, *Pressure of Population and Economic Efficiency in India*, p.59.

[3] *Agricultural Commission Report*, p. 493.

cipate in an active manner, since the addition of fish offers the best chance of enriching the diet of a primarily rice-eating people.[1] Large sections of the people have no religious or other objections to the consumption of fish and full advantage should be taken of this fact.

There was a time when it was the fashion of writers and reformers even in England to decry what was called 'the vice of tea-drinking', and declamations against 'tea-bibbers' were common.[2] But the English working classes have persisted in its use until tea has become an important item among their necessaries of life. Public opinion with regard to tea-drinking has also taken a right-about turn, and tea-sipping instead of being regarded as a vice has now come to be 'a sign of domesticity and temperance'. Tea-drinking is generally advocated as a substitute and remedy for drunkenness. Dr Slater remarks that the Indian peasant is very poor in one particular commodity, which he does not properly appreciate, and that is good drink.[3] 'The great mass of people drink filthy water, water drawn from rivers and irrigation channels and containing every kind of impurity, and from stagnant tanks which are also little better guarded.' Dr Slater believes that 'one of the greatest benefits which could be conferred upon India at the present time would be to popularize the use of tea, the cheapest of all boiled-water drinks'. However, the dangers of drinking impure water are not eliminated so long as some water at least continues to be used for drinking purposes. A more effective course would be to ensure the supply of pure water. As an alternative to alcohol, tea may no doubt be regarded as a boon. At the same time excessive tea-drinking can be harmful to the constitution, especially when inferior brands are used, as in most teashops in India. Some steps seem to be necessary in order to ensure that reasonably good tea is sold in teashops, instead of the vile decoction generally served, though doubtless the most effective remedy would be an improvement in the taste of the people themselves.[4]

[1] ibid., pp. 411-17. The Commission also suggested that a Central Institute of Human Nutrition should be established, with which the research, also to be organized by the Provincial Governments, should be co-ordinated. They further recommended a closer collaboration between research on animal nutrition and that on human nutrition, and also between all these investigations in India with similar investigations in other parts of the world. 'The problems are so vast that all the staff and material available should be mobilized to assist in their solution.'

[2] Helen Bosanquet, *The Standard of Life*, p. 30.

[3] *Some South Indian Villages*, p. 232.

[4] Coffee-drinking, which is widespread in South India, gives rise to similar reflections. Expenditure on alcoholic drinks and the policy to be pursued with regard to it will be referred to later (see ch. xii). Other well-known instances of misdirected consumption which will readily occur to the student of Indian economics are the unduly heavy expenditure on marriages, funerals, and gold and silver ornaments (see section on 'The hoarding habit' in ch. xi).

On the subject of nutrition the reader is referred to the *Bengal Famine Inquiry Commission Report*, Pt II, pp. 106-40.

CHAPTER V

TRANSPORT

§1. **Importance of transport.**—The importance of transport from the economic, military, administrative, cultural, and social points of view is hardly in need of special emphasis. Throughout the whole history of India difficulties of communication have been a predominant factor in determining political and economic development. The expenditure involved in equipping the country with an up-to-date system of transport at all adequate to its requirements would indeed be enormous. India is a subcontinent, the distances to be traversed are tremendous and the natural obstacles to be overcome in passing from one region to another are formidable while, even within a restricted area, internal communication often breaks down altogether in the rainy season. Again, India is less fortunate than other countries, like England, in respect of waterways, which historically have played a very important part in facilitating commerce in many countries, especially before the advent of railways.

The means of communication in India were, comparatively, very defective till as late as the middle of the nineteenth century, and were reminiscent of England in the middle of the eighteenth century, though, owing to the more favourable climatic conditions, the roads were better in India than in England. Railways had yet to come, and the few trunk roads constructed by Indian rulers, especially in northern India by the Moguls, were thoroughly inadequate.[1] Many of the so-called roads were mere tracks cut by village carts across the face of the country, and the movement of wheeled traffic was for the most part impossible during the rainy season. Pack animals led by caravans or *labans* were the only means of access to many parts of the interior. Moreover, the roads were unsafe, being infested by highwaymen like the Thugs and the Pindharis. There were no navigable canals to speak of, though a few regions such as those along the Ganges and the Indus—which were then great natural highways of commerce—and the coastal districts were more fortunately situated in this respect than others. On the whole, the state of communications in northern India with its vast plains easily traversable in the dry season, its navigable rivers and a few 'made' roads, was much more satisfactory than in the peninsula with its rugged mountainous territory and poor facilities for water transport except on the two coasts.

We have already discussed the economic and social effects of the imperfect means of communication and dwelt on the isolation and self-sufficiency of the village and the prevalence of local economy with all its attendant handicaps in respect of markets and division of labour; the immobility of labour and the conservatism of the people; and the violent dislocation of the otherwise smooth routine of economic life in times of scarcity and famine.[2] A veritable economic and social revolution has, however, been wrought by the modern improvements in communication and transport dating from the time of Lord Dalhousie, who initiated

[1] See W. H. Moreland, *India at the Death of Akbar*, pp. 166-7. [2] See vol. I, ch. v.

a vigorous public works policy. In this chapter we shall give a short account of the various efforts made in this connexion.

We may for the sake of convenient treatment divide the subject into its four main sub-divisions: (i) railways; (ii) roads; (iii) waterways; and (iv) air transport.

RAILWAYS

§2. **Diversity of relations between the State and the railways.**[1]—A special feature of the Indian railway system has been the diversity of relations between the State and the railways in respect of ownership and control. Among the more important lines four were until recently owned and worked by the State (the North-Western Railway, Eastern Bengal Railway, East Indian Railway, with which was amalgamated the Oudh & Rohilkhand Railway from 1 July 1929, and the Great Indian Peninsula Railway),[2] five were owned by the State but worked on its behalf by companies enjoying a guarantee of interest from the Government (the Bombay, Baroda & Central India, Madras & Southern Mahratta, Assam-Bengal, Bengal-Nagpur, and South Indian railways); two important lines (the Bengal & North-Western and Rohilkhand & Kumaon) and many others of less importance were the property of private companies, some being worked by the owning companies and some by the State or by the companies that work State-owned systems. Several minor lines are the property of the District Boards or enjoy a guarantee of interest granted by such Boards. Of the total route mileage of Indian railways amounting to 41,134 miles on 31 March 1939, the State owned 29,764 miles or about 72 per cent, and directly managed 17,158 miles or about 42 per cent of the total mileage open at that time.

§3. **Main periods of railway history.**—Ten well-defined periods in the history of Indian railways may be distinguished; (i) 1844-69: the old guarantee system; (ii) 1869-79: State construction and management; (iii) 1879-1900: the new guarantee system; (iv) 1900-14: rapid extension and development, and commencement of railway profits; (v) 1914-21: breakdown of the railway system under stress of conditions created by the war of 1914-18; (vi) 1921-5: the Acworth Committee and the overhauling of railway policy on the basis of direct management and control by the State; (vii) 1924-5 to 1929-30: the Separation Convention, period of prosperity; (viii) 1930-1 to 1935-6: depression; (ix) 1936-9: partial recovery and Railway Inquiry; and (x) 1939 onwards.

§4. **The old guarantee system (1844-69).**—The first proposals for the construction of railways were made in 1844 and contemplated the construction of lines by railway companies incorporated in England and enjoying a guarantee by the East India Company of a specified return. Accordingly, contracts were made for the construction of two small railway lines near Calcutta and Bombay with the East Indian Railway Company and the Great Indian Peninsula Railway Company respectively. It was, however, Lord Dalhousie's famous Minute on the subject in 1853 that gave a decisive turn to Government policy in this direction. In this Minute, Lord Dalhousie urged the creation of a system of trunk lines con-

[1] See *Report on Indian Railways* (1938-9), vol. I, Appendix B.

[2] The Burma Railways were separated from the Indian State Railways with effect from 1 April 1937 following the separation of Burma from British India.

necting the interior of each Presidency with its principal port and connecting the different Presidencies with one another. He emphasized the great social, political and commercial benefits to be expected from railways to both India and England. One of the results which Lord Dalhousie contemplated with satisfaction from rapid railway construction by British companies was a more extensive employment of English capital and enterprise in Indian trade and manufactures. He preferred the agency of companies, under the supervision and control of the Government, to direct construction by the Government, because he thought that the conduct of commercial undertakings did not fall within the proper functions of the Government, especially in India, where it was necessary to discourage the people's habit of dependence on the Government for everything.

In accordance with Dalhousie's plan, contracts were entered into with eight companies between 1854 and 1860 for constructing and managing railways in different parts of India. A fresh stimulus to railway construction was given by the experience during the Mutiny period, when movements of troops and material were seriously impeded owing to defective transport. The main features of the contracts with the early guaranteed companies were as follows:—(i) free grant of land; (ii) a guaranteed rate of interest, ranging from 4½ to 5 per cent and payable at 22*d.* per rupee; (iii) utilization of half the surplus profits earned by the companies to repay the Government any sums by which they might have had previously to make good the guarantee of interest, the remainder belonging to the shareholders; (iv) reservation of certain powers of supervision and control by the Government in all matters of importance except the choice of staff; and (v) option to the Government to purchase the lines after twenty-five or fifty years on terms calculated to be the equivalent of the companies' interest therein.

This system, however, proved to be a great drain on the resources of the State and a burden on the taxpayer in India. For the companies were unable to earn their interest and called upon the Government to make good the deficiency. The deficit on the railway budget amounted to Rs. 1,66,50,000 by 1869. This was attributed by several critics like Lord Lawrence, who in his Minute in 1867 had strongly condemned the guarantee system, to the extravagance of the companies who had no incentive for economy in construction.[1] The Acworth Railway Committee, however, expressed the opinion that the formation of English-domiciled companies was the only wise course for the time, in view of the urgent need for railways and the shyness of Indian capital, making it necessary to offer special attractions to British capital for this purpose. On the other hand it was put in evidence before the Parliamentary Committee of 1872 by William Thornton, that unguaranteed capital would have gone into India for the construction of railways had it not been for the guarantee. England had an immense amount of superfluous capital which was seeking outlets in South America and other countries, and it was not conceivable that it would persistently have neglected India.[2] Also the contention that the rate of interest actually guaranteed was needlessly high is strengthened by the later experience of the Government when they were able, without much difficulty, to enter into contracts on terms much less favourable to the companies

[1] See R. C. Dutt, *The Economic History of India in the Victorian Age,* pp. 355-6.

[2] ibid., p. 390.

in respect of the guaranteed rate of interest and other concessions. We may also point out that while the Government showed their active interest in the promotion of railways, they did not exert themselves to build up any of the industries required to supply the materials demanded by the railways and this made them all the more expensive.

§5. **State construction and management (1869-79).**—The Government of India were not prepared to continue the old guarantee system, their objections being the extravagance of the companies, the absence of effective Government control over them, the inconvenience to the Government of a guaranteed rate of interest on the capital of the companies, and the remoteness of the prospect of securing a share of the surplus profits to themselves. Two important changes were consequently made. In the case of some of the more important railway companies, like the Great Indian Peninsula, the arrangements regarding the distribution of surplus profits were altered so as to enable the Government to claim unconditionally half the surplus profits for each half-year, the Government relinquishing their right to purchase the lines at the end of the first twenty-five years from the dates of the respective contracts. An even more important change in policy—remarkable for the sixties when *laissez-faire* ideas held the field—occurred when the Secretary of State decided that, so far as capital for new lines in India was concerned, the State should secure for itself the full benefit of its own credit and of the cheaper methods of construction, etc. which it was expected it would be able to use. Accordingly, for several years after 1869, the capital expenditure was chiefly incurred direct by the Government, and no fresh contracts with guaranteed companies were made. It was decided to borrow annually amounts up to £2 million for constructing lines to be managed by the State and a new cheaper gauge, namely the metre gauge, was adopted. A vigorous programme of railway construction then followed with satisfactory results so far as the costs were concerned. But the main difficulty was in respect of continuous and adequate provision of funds. In the first place, the Sind and the Punjab lines (later known as the North-Western) had to be converted from metre to broad gauge for strategic reasons. Secondly, the financial difficulties of the Government were increased by the inroads which the falling rupee was making on the exchequer, by the famines between 1874 and 1879, and by the Frontier War with Afghanistan. Moreover, the Famine Commission of 1880 held that 5,000 additional miles of railway were urgently needed and that the country could not be held safe from famines until the Indian railway mileage had aggregated 20,000. The Government were thus forced to the conclusion that the State alone could not find sufficient funds for pushing ahead with railway construction as fast as the Famine Commission recommended, and decided again to take the help of capital borrowed by private companies.

§6. **The new guarantee system (1879-1900).**—Thus by the early eighties the current of thought in favour of State management had spent its main force, and a new period in railway history was ushered in when the Government decided again to utilize the agency of guaranteed companies with certain modifications of the old terms, and contracts were made with the new guaranteed companies, such as the Bengal-Nagpur, and the Madras & Southern Mahratta railway companies. The

chief differentiating features of the new guarantee system were as follows:—(i) the lines constructed by the companies were declared to be the property of the Secretary of State for India, who had the right to determine the contracts at the end of approximately twenty-five years after their respective dates, or at subsequent intervals of ten years, on repaying at par the capital provided by the companies; (ii) interest was guaranteed on the capital raised by the companies at a lower rate, the most usual rate being 3½ per cent; (iii) the Government retained a much larger share (usually three-fifths) of the surplus profits for their own benefit.

Thus the lines constructed under the new system by the companies were from the beginning the property of the Government, though the companies were given a certain guaranteed rate of interest on the portion of the capital raised by them and were allowed to manage the lines when completed.

Similarly, when the contracts with the old guarantee companies expired, the Government in most cases exercised their right of terminating them, though the method of making use of this right differed in different cases. In some cases, for example the Eastern Bengal, the Oudh & Rohilkhand and the Sind-Punjab railways, the lines were purchased and transferred to State management. In other cases, like the East Indian and the Great Indian Peninsula, the lines were acquired by the State, but were handed over again for management to the same companies under revised contracts. So also, when the contracts with the new guarantee companies expired, though arrangements were made for the continuance of management by the original companies, the Government secured more favourable financial conditions by various methods, such as reduction in the companies' share of capital and in the rate of interest guaranteed, and further modification of the clauses relating to the division of surplus profits.

§7. **The present position.**—The State has now come to be the owner of all the trunk lines. The capital has become its property, either through having been originally supplied by it or through the acquisition by the Government of the companies' interests on the termination of the old contracts. The management of the railways, except in a few cases, was at first left to the companies, subject to Government's power to appoint a Director on the boards of the companies and to Government control, exercised, since 1905, through the Railway Board, with regard to matters like the standard of repairs, rolling stock, public safety, co-ordination of the railway systems, train services, rates and fares, etc. The contracts with the companies (except one fixed for a term of twenty-five years) were terminable at the option of the Secretary of State at specified dates on payment of the companies' capital at par. The last of these contracts to expire, viz. that with the Bengal-Nagpur Railway, was to terminate in 1950. But the State actually took over the line from 1 October 1944.

§8. **Rapid extension and development of railways and commencement of railway profits (1900-14).**—The main features of this period were the rapid development of railways as part of a new and much more vigorous policy of national development affecting almost every branch of economic life. The railways attained to the dignity of a separate department in 1905, when the Railway Branch of the Public Works Department was abolished, and a Railway Board consisting of a president and two members was established at the head of the railway system under

the Department of Commerce and Industry. A fresh impetus was given in 1908, when the Mackay Committee on Railway Finance laid down for the future a standard of £12,500,000 as the annual programme for capital expenditure on railways, though it was to be subject to periodical revision. Although the Government were neither able to attain the standard recommended by the Mackay Committee nor allowed to adhere over a series of years to any uniform rate, they spent sums considerably larger than had been the case in previous years. The railway mileage in this period increased from 24,752 in 1900 to 34,656 in 1913-14, and the capital outlay, from Rs. 329·53 crores to Rs. 495·09 crores.

Another notable characteristic of this period was the commencement of railway profits in 1900. The unprofitable character of railways till approximately that date was due to uneconomical construction and management by the old guarantee companies, the construction of unremunerative strategic lines, like the North-Western Railway, and those constructed for the purpose of famine relief, and the absence of traffic in the initial stages. The losses to the State during the first forty years of the existence of the railways amounted to Rs. 58 crores. After that the railways began to yield a net return to the State on the capital outlay at charge, thanks to the general economic development of the country, and especially of the Punjab and Sind under their irrigation works—which enabled even the Frontier Railway, for a long time regarded as the Cinderella of Indian railways, to pay its way—and the renewal of the original contracts with the guaranteed companies under terms more favourable to the Government. The gain to the State was small for the first ten years after 1900, but by 1924 the total gain had accumulated to Rs. 103 crores. Railway profits, however, are subject to remarkable variation from year to year, depending as they do on the agricultural position and the course of the internal and external trade of the country. The adoption of the recommendations of the Acworth Committee, and the retrenchment carried out as suggested by the Inchcape Committee (1922-3), placed Indian railways in a sounder financial position than before. On the capital at charge of the State, the percentage of net earnings (gross receipts minus working expenses), before deducting interest on capital at charge, has varied between 2·6 per cent in 1921-2 and 7·5 per cent in 1918-19, the average rate between 1913-14 and 1938-9 being a little over 4 per cent.[1]

The Retrenchment Committee laid down that a five and a half per cent net return on the capital outlay should be aimed at by the railways. Regarding the railway profits declared by the Government, Mr Chandrika Prasad observes: 'In declaring surplus profits on the railways, especially during recent years, the ordinary commercial principle of allowing for depreciation on stock has not been applied.' He contends that the profits declared must be subjected to considerable discount on this account. This position was upheld by the Acworth Committee, who strongly recommended that each railway should make adequate provision annually for the maintenance and the renewal of its permanent way and rolling stock. The question of the financial results of the working of railways is further dealt with in chapter xii.

[1] Owing mainly to the adverse effects of the trade depression the railways sustained heavy net losses after paying interest charges from 1930-1 to 1936-7 (both years inclusive).

§9. **Breakdown of the railway system (1914-21).**—This period is characterized by the utter breakdown and rapid deterioration of the railways, partly because of the strain to which they were subjected by the large movements of troops and materials at a time when a part of the rolling stock, staff, etc., was required for the construction and working of the military railways in Mesopotamia and other theatres of war, and partly because of the general financial embarrassment of the Government, who were compelled seriously to curtail the annual programme of capital expenditure on railways. To add to all this, it was extremely difficult to obtain any railway material from England during this period. Not only had the fresh extension of railways to be practically held up but even the existing lines could not be maintained in good condition. The Acworth Committee give the following picture of the breakdown of the railway system under the stress of war conditions: 'There are scores of bridges with girders unfit to carry train loads up to modern requirements; there are many miles of rails, hundreds of engines, and thousands of wagons, whose rightful date for renewal is long overpast.' It is no matter for surprise, therefore, that loud complaints were made by the public and the trading community about the great inconvenience to passenger and goods traffic. Public opinion was becoming steadily hostile to the management of the bulk of the State railways by English domiciled companies and demanded that the State should take over the management wherever possible.

§10. **The Acworth Committee.**—It was also being increasingly realized that the Railway Board, as it was constituted, was not able to take the initiative in laying down railway policy and failed to exercise effective control over the railway administration, especially in regard to fares and rates, being overloaded with routine, trammelled by unnecessary restrictions and handicapped by its ignorance of local conditions and inadequately provided with technical and inspecting staff. The need for a fresh lead was also felt in respect of the future policy of railway finance. All these questions were, therefore, referred to a special committee appointed in November 1920, and presided over by a railway expert from England, the late Sir William Acworth. The immediate cause of the appointment of the committee, however, was the question as to the action to be taken in connexion with the East Indian Railway, State-owned but managed by the East Indian Railway Company, whose contract with the Government was terminable in December 1919. As a temporary measure the old contract was extended to the end of 1924, and the general questions arising out of the discussion regarding the respective merits and demerits of various possible systems of management were referred to the Acworth Committee. After a comprehensive inquiry the Committee issued their Report in the following year, embodying their findings on several questions of importance. Before proceeding to review the Report, we shall first deal with the State versus Company management controversy.

§11. **Case for State management in India.**—On theoretical grounds the case against railway management by the State may be conceded to be strong.[1] But when we come to consider, with reference to any particular country, whether it ought to adopt company or State management, a simple appeal to theory is of little use. Actually, historical causes rather than theoretical considerations have deter-

[1] Consult on this subject W. M. Acworth, *State Railway Ownership*.

mined any particular system in operation, and different countries are prospering more or less under different systems. The Government undertake railway business for various reasons, either political, or in order to make up for the lack of private enterprise, or again, in order to secure for the people cheaper rates, better facilities and more impartial treatment of the various interests. All those reasons have been more or less powerful in India in strengthening the case for State management. Moreover, company management in the true sense of the word is impracticable in this country, and, therefore, as the Majority Report of the Acworth Committee points out, the whole reference to foreign countries and the relatively greater success achieved by company management elsewhere was irrelevant. State ownership already existed for the most part in this country and also direct State management. Most of the State-owned railways were, however, managed by companies with a London domicile. But there had been a general consensus of opinion that the management of all the railways should be taken over by the State. This opinion was supported by the Majority of the Acworth Committee and Indian public opinion generally. The Committee's case for State management in India is substantially as follows:[1]

Though a company investing its own money, managing its own property and judging its officials by their success in producing results in the shape of dividends usually conducts business with more enterprise, economy and flexibility than are common in businesses directly managed by the State, the English companies managing State Railways in India had long ceased to be companies in this sense. The property entrusted to their management was not their own and their financial stake in it was comparatively small.[2] Such a system has never worked satisfactorily in the past and cannot be made to do so in the future. The management is only nominally entrusted to the companies, for the Government, feeling themselves to be the real owners, have left no real initiative in the hands of the companies. Important matters like the creation of appointments, etc. are largely controlled by the Government. Thus the companies could not and did not manage the undertaking, and could not break new ground in any direction except with the sanction of the Government. The Government did not feel an obligation to take any initiative themselves. Nor could they stir up the companies, if they were supine. In short, it was a system under which a progressive company was hampered by meticulous Government control over every detail of expenditure, and under which, on the other hand, the utmost wisdom on the part of the Government was not able to prevent injuries caused by the unwise and unprogressive policy of a company's board, both to the revenues of the State and the economic development of the country. As regards the

[1] cf. *Acworth Committee Report*, pars. 210-39.

[2] In this connexion, the following figures will be found interesting. The total capital outlay at charge on all railways, including those under construction, amounted to Rs. 852·59 crores at the end of March 1940. Out of this, Rs. 758·62 crores was capital at charge on State-owned railways, including premia paid in the purchase of companies' lines. The remainder, Rs. 93·97 crores, represented capital raised by Indian States, companies and District Boards. By far the greater portion of this amount, namely Rs. 729·72 crores, is Government capital and only one-twentyfifth, or Rs. 28·89 crores, is owned by companies. The figures include Rs. 38·82 crores on account of capital expenditure to the end of March 1940 on strategic lines. See *Report on Indian Railways* (1939-40), vol. I, par. 33.

proposal put forward by the Minority, that the management should be transferred from English to Indian companies, the first objection was that the Indian companies would have only a minority interest in the undertaking. The State would remain the predominant partner, appoint one-half of the directors and nominate the Chairman and so retain its control. The division of responsibility between the Government and the Board of Directors would still continue, and the executive officers, with a divided allegiance to a Board of Directors which appointed and paid them, and to the Government which stood behind the directors, could not do the best work of which they were capable. Competent business men would refuse to join the Board if they found their power limited by Government control and Government regulations, and this seemed inevitable under the plan advocated by the Minority. A mere change in the domicile of the company, therefore, would not improve matters, as companies substantially independent of Government could not be formed in India, and without such independence the advantages of private enterprise could not be gained. Indian domiciled companies, again, would not be able to be of much assistance in raising the necessary funds for railway construction. The Government would always have to take the larger share of this work on themselves, and they would find this task much easier under a system of State management than under company management. Company management, whatever the domicile, would be unpopular in India. From the financial, economic and political point of view money required for Indian railways should be raised in India itself as far as possible and these loans would be more readily subscribed to by the public if the Government themselves took over the management of the railways. Again, if resort to external loans was necessary, the credit of the Government of India was always an asset of inestimable value. One of the most important arguments in favour of State management in this country was the generally accepted view that foreign company management had shown itself wilfully negligent of national interests. These evils would have a greater chance of being remedied under State management. Actual experience of State management in India had shown that it did not in any way compare unfavourably with company management. The vested interests of the railways in the different parts of the country controlled not merely the carriage of goods and passengers, but also the construction of new lines, trunk or feeder, and the connexions of two or more different lines. Spheres of influence had come into existence and formed an obstacle in the way of proper railway development. Under State management this evil would be avoided, and lines would be constructed as demanded by the real interests of the country. Again, under State management, the convenience of traders and passengers would be much better attended to.[1] The grievances of the public had a much greater chance of being speedily and effectively redressed under State management. The Boards of the railway companies situated in London had been generally insensible to such representations from Indian interests as happened to reach them. On the other hand, European merchants being better organized and better represented in England had been able to make their voice more easily heard. Such a state of things was

[1] As Mr N. B. Mehta points out, the lack of inter-railway competition and of a vigilant public opinion has made State control almost a moral obligation in India. See *Indian Railways: Rates and Regulations*, p. 81.

not conducive to the rapid development of Indian commerce and industry. Control exercised from a distance of 6,000 miles unduly fettered the railway executive on the spot.

Point was lent to this controversy when the contracts with the Great Indian Peninsula and East Indian Railways were due to expire in 1924-5. In February 1923, the matter came up before the Assembly. The feeling of Indian non-official members was decidedly in favour of wholehearted State management, with the consequence that the simple motion for taking these two railways under State management was passed. They were accordingly taken over by the Government for direct management. (The Burma Railways also passed under State management from January 1929.) The Southern Punjab Railway was purchased by the State in 1930. It was worked by the North-Western, a State-owned and State-managed railway. The B.B. & C.I. and the Assam-Bengal Railways were taken over for State management with effect from 1 January 1942, and from 1 January 1943, the Bengal and North-Western, and Rohilkhand and Kumaon Railways were similarly taken over and amalgamated under the name of the Oudh and Tirhut Railway.

§12. **Separation of railway finance from general finance.**—The Acworth Committee urged the separation of railway finance from general finance on various grounds. In the first place it would remove the element of uncertainty in the annual Budget estimates due to the inclusion therein of railway profits. These vary according to the character of the season and trade conditions, with the result that the estimates might be out by several crores of rupees. The case for separation was seen to be even stronger from the railway standpoint. The dependence of the railways on the exigencies of the General Budget prevents them from being run on a commercial basis. An arrangement which assumes that the railway concern goes out of business on 31 March every year and begins life afresh at the beginning of each official year was obviously detrimental to the railways. The separation of the two budgets was calculated not only to enable the railways to be conducted as a business undertaking, but also to free the Government from the many difficulties and uncertainties of the old system. In view of the importance of the subject a resolution was brought before the Legislative Assembly in September, 1921, when a Joint Committee of the two houses was appointed to investigate the question. The committee declared immediate separation to be outside practical politics. They were, however, impressed with the necessity of rehabilitating the existing railway lines, which had been utterly neglected during the war period, and recommended a guaranteed programme of Rs. 150 crores to be distributed over a period of five years and to be spent upon the improvement and completion of the existing lines, and provision of better amenities for third-class passengers. The Assembly endorsed this recommendation (1924) and it was also induced to accept the scheme for separating railway finances from general finances on the condition of ensuring to the latter a definite ascertainable annual contribution from railways, which was to be the first charge on their net receipts. This contribution was settled upon the basis of one per cent on the capital at charge of commercial lines, excluding capital contributed by companies and Indian States, at the end of the penultimate financial year, plus one-fifth of the surplus profits in

that year, interest on capital at charge of strategic lines and loss in working being deducted. The Legislative Assembly stipulated that if, after payment of the contribution so fixed, the amount available for transfer to the Railway Reserve should exceed Rs. 3 crores, one-third of the excess should be paid to the general revenues. This Railway Reserve was to be used to secure the payment of the annual contribution, to provide, if necessary, for arrears of depreciation and for writing down capital, and generally to strengthen the financial position of the railways. It was expected that by this arrangement the Indian taxpayer would be assured of a regular contribution in relief of taxation from his investments in railways, while the task of maintaining a continuous financial policy and of distinguishing between a temporary or permanent surplus or deficit in accounts would be immensely facilitated. The first separate railway budget under this scheme was presented to the Assembly in March 1925. The financial results of the Separation Convention are reviewed in chapter xii.

§13. **The Wedgwood Railway Inquiry Committee (1936-7).**—The serious deterioration in the financial condition of the railways from 1930 to 1936 created a persistent demand for a searching inquiry into their affairs. Sir Otto Niemeyer, the financial expert who came out to India in January 1936, put in a strong plea for a thoroughgoing overhaul of railway expenditure and the early establishment of effective co-ordination between the various modes of transport in his Report on Financial Settlement between the Central Government and Provinces under the new Constitution (1935). His Report[1] imparted a new urgency to the problem of financial re-organization of railways by making the assignment of a half share of the income-tax by the Central Government to the Provinces dependent upon the Railways paying their way and resuming their contribution to general revenues. The Public Accounts Committee of the Legislative Assembly strongly endorsed Sir Otto Niemeyer's suggestion in its Report issued from Delhi in September 1936. Accordingly the Indian Railway Inquiry Committee was appointed in October 1936 with Sir Ralph L. Wedgwood, Chief General Manager, London & North-Eastern Railway, as Chairman.

The Report of the Committee, published in June 1937, contains many valuable suggestions concerning almost every aspect of railway working for improving efficiency and effecting economy. It reaffirmed the majority of the recommendations of the Pope Committee, which during the years 1932-4 had inaugurated a detailed analysis of every important activity of railway operation with a view to carrying out economies and attaining greater efficiency. It urged the need for an adequate depreciation fund and considered that a normal balance of Rs. 30 crores would not be excessive. It further recommended that the railways should build up a general reserve fund to serve as an equalization fund for the payment of interest charges and amortization of capital.[2]

The Committee rightly stressed the importance of the railways increasing their popularity and improving their relations with the public, and to this end recommended closer liaison with the Press through a press liaison officer and a

[1] *Indian Financial Enquiry (Niemeyer) Report*, par. 31, published in April 1936. (See ch. xii.)

[2] *Report*, pars. 206 and 210-11.

Railway Information Office. The Committee did not favour large amalgamations of railways as a general policy lest they should result in unwieldy administration.[1] The recommendations of the Wedgwood Committee regarding revision of rates and fares, and rail-road co-ordination, are dealt with in later sections.

§14. **Indian railways during World War II.**—One of the results of World War II was the increased traffic, making abnormal demands on transport capacity. The railways were better equipped to face the situation than during the previous war (see §9 *ante*) thanks to the period of prosperity that followed it. Large sums had been spent upon new constructions, on improvement in working methods, on more powerful locomotives, etc. In his speech on the Railway Budget for 1940-1, Sir Guthrie Russell, Chief Commissioner for Railways, estimated that the railways could, with their existing capacity, if the necessity arose, absorb all the coastwise traffic, except coal.[2] Handicaps the railways had to face were the depletion of supervising staff, consequent on the release of railway personnel for military service, and the dismantling of branch lines for shipment overseas.

Some Problems of Railway Administration

§15. **Railway rates policy.**—It had been a longstanding Indian grievance that the railway rates in this country were based solely on considerations of pecuniary advantage to the railways and were manipulated so as to help European merchants and hinder the development of Indian industries and enterprise. This complaint was voiced by Sir Ibrahim Rahimtulla in the Imperial Legislative Council in 1915, as also by a number of witnesses before the Industrial and Fiscal Commissions and the Acworth Committee. One of the specific charges in this connexion was that the rates were framed so as to encourage traffic to and from the ports at the expense of internal traffic, thus encouraging the export of raw materials and the import of foreign manufactures.[3] Indian business men and industrialists complained that they often had to pay rates which they considered unfair, both on the raw materials which they had to obtain from other parts of India and on the manufactured articles which they dispatched to various markets. The 'block rates' system[4] also aroused much discontent as leading to an artificial diversion of traffic inconvenient to industry and trade. An incidental effect of the railway rates policy in the past was the congestion of industries in the port towns, which is responsible for many of their present difficulties. For example, the serious labour difficulties are to no small extent due to the concentration of industries in centres situated far away from the interior. The adverse effect of the railway rates policy on water transport in India is referred to in a later section.

As the Fiscal Commission admitted, complaints regarding the unfair treatment meted out to Indian industries were not entirely without foundation. In practice the railways have enjoyed full discretion in manipulating the rates within the limits

[1] *Indian Railway Enquiry Report*, chs. xii and xiii.

[2] *Railway Budget for* 1940-41, par. 2.

[3] See *Fiscal Commission Report*, par. 127.

[4] 'Block rates' mean higher mileage charges for short lengths imposed on traffic moving from a station near a junction in order to travel a much longer distance over another railway. The object is to retain traffic on the line on which it originates and prevent or 'block' it from passing, after only a short lead, on to a rival route.

sanctioned by the Railway Board and in putting particular commodities into particular classes. The Industrial Commission, after carefully going into the question, made recommendations in favour of the rating of the internal traffic as nearly as possible on a basis of equality with traffic of the same class and over similar distances to and from the ports, so as to encourage the transformation of the raw materials into the most finished state possible before export. They also recommended that consignments travelling over more than one line should be charged a single sum based on the total distance. The Fiscal Commission endorsed these recommendations, and held that, within the limitations laid down by their predecessors, special rates should be granted for a term of years to new industries, and even to others if they could make out a proper case for special treatment. The Agricultural Commission, who examined the question of railway rates policy in its bearing on agricultural development, suggested a closer co-ordination between the Agricultural Departments and the railways, and recommended the grant of concession rates on the transport of fertilizers, fuel, fodder, milch cattle, etc. They further suggested a re-examination of rates on raw material for, and transport of, agricultural machinery and implements.[1] Some of these recommendations were accepted by the Government of India in April 1930. Agricultural implements have been reclassified with the object of removing anomalies. The rates for carriage of live stock have been examined and reductions have been made. The Wedgwood Committee noted the criticism that the structure of Indian railway rates was cumbrous and illogical and called for drastic simplification. They recommended that the Railway Board should inquire into the system of charging at scheduled rates with a view to simplification.[2]

As recommended by the Acworth Committee, a Rates Advisory Committee consisting of a President, one member representing the commercial interests and another representing the railways, was appointed in 1926 to investigate and make recommendations to the Government on the following subjects; (i) complaints of undue preference, (ii) complaints that rates were unreasonable in themselves, (iii) complaints or disputes in respect of terminals, and complaints that railway companies did not fulfil their obligations to provide reasonable facilities to trade, (iv) the reasonableness or otherwise of any conditions as to the packing of articles specially liable to damage, or liable to cause damage, (v) complaints in respect of conditions as to packing attached to a rate. As recommended by the Wedgwood Inquiry Committee the procedure of the Committee was simplified and made more expeditious in 1940.

§16. **Reorganization of the Railway Board.**—The Acworth Committee suggested reorganization of the Railway Board so as to make it a satisfactory agency through which the Government of India could exercise effective supervision over the whole railway system in the country. The reorganized Railway Board consists of a Chief Commissioner, a Financial Commissioner and three members.[3] Instead

[1] *Agricultural Commission Report*, pp. 377-9.

[2] *Indian Railway Inquiry Committee Report*, par. 127.

[3] The post of one member was held in abeyance. For some criticisms and suggestions concerning railway administration see *Indian Railway Inquiry Committee Report* (1937), pars. 78-90.

of the Acworth Committee's recommendation of three territorial divisions with a Commissioner in charge of each, the plan of dividing the work on the basis of subjects has been adopted. One member deals with technical subjects, and another with general administration, personnel and traffic subjects, the Financial Commissioner representing the Finance Department on the Board and dealing with all financial questions. The Board is assisted by five Directors (for Civil Engineering, Mechanical Engineering, Traffic, Finance, and Establishments) who relieve the Chief Commissioner and the members of much current work, enabling them to devote their attention to large questions of railway policy, to tour over the various railway systems and to maintain personal touch with local Governments to a greater extent than was previously possible.

§17. **Railway Advisory Committees.**—The Committee recommended the establishment of Central and Local Advisory Councils to give the Indian public a voice in railway management. Accordingly all railways came to possess Advisory Committees, besides a Committee of the Central Legislature consisting of representatives from the Assembly and the Council of State.

§18. **Indianization, etc.**—Both the Acworth Committee and the Lee Commission (1923) recommended the extension of facilities for training Indians for the superior railway services, a standard of seventy-five per cent of such posts being laid down by the latter body. The Government accepted this recommendation and steps were taken to extend training facilities. The Government of India reaffirmed the policy of Indianization of railway services in the course of the debate on the Wedgwood Committee's Report (see §13 above). European recruitment has now stopped and Indianization has ceased to be a live issue with the passing of political power to Indian hands.

The Acworth Committee also made recommendations for meeting a number of popular grievances. The Government have taken certain steps to this end, such as adding to the rolling stock, extending platform and waiting-room accommodation, erecting new stations, providing better water-supply, appointing Controlling Passenger Superintendents, etc. The third-class passenger contributes the largest amount to the railway earnings from passenger traffic; and, apart from other considerations, it may be good business to increase the attractions of travel for him.

§19. **Federal railway authority.**—By the Government of India Act of 1935 it was provided that, while the Federal Government and Legislature should exercise a general control over railway policy, the actual administration of railways in India (including those worked by companies) should be placed in the hands of a statutory railway authority which would be the executive authority of the Federation in respect of the regulation, construction, maintenance and operation of railways. The railway authority had to act on business principles consistently with due regard paid to the interests of agriculture, industry, commerce and the general public. In the discharge of its functions it was to be guided by such instructions on questions of policy as it might be given by the Federal Government.

The provisions of the Government of India Act (1935) regarding the Federal Railway Authority met with much opposition on the ground that they considerably detracted from the legislative and popular control over railway policy and adminis-

tration. The Federal Railway Authority, like other parts of the federal structure envisaged by the Government of India Act of 1935, never materialized.

§20. **Economic effects of railways.**—The advantages of railways (as of other means of annihilating distance) from the political, social and cultural point of view are obvious and need not be dwelt upon here. Efficient administration, military defence, famine relief, the growth of trade and industry, an effective exploitation of the resources of the country, an even distribution of its population—all depend on railways as the most important form of practicable transport. The growth of towns and port development are also rendered possible by railways. The railways can also render invaluable assistance in conducting publicity campaigns for the improvement of sanitation as well as for the introduction of reform in agricultural practice. Lastly, Government revenues benefit both directly and indirectly from the railways: directly, because the Government share in the profits from the railways, and indirectly because they increase the total wealth of the country and consequently the taxable capacity of the people.

Railways, however, have not been an unmixed boon in India. We have already spoken of the part which railway construction has played in hastening the destruction of indigenous industries and in bringing about a one-sided economic development of the country, under which its exports consist almost entirely of raw materials, and its imports of manufactured articles. As regards the help derived from railways in the matter of organizing effective famine relief, we must not forget that there is another side to the picture. Railways have increased the ruralization of the country by contributing to the decline of the indigenous industries, and this has rendered large numbers of people, especially artisans like weavers, more susceptible to famine than they used to be. Thus if the railways have facilitated the work of famine relief, they may be said, on the other hand, to have increased the volume of this work. In the earlier days of railway development, the fuel requirements of railways led to the reckless destruction of forests until the Government took the necessary steps to check this process. Railway development in this country also meant the introduction of foreign capital and foreign investment, and this, as we have already seen, brought certain serious disadvantages along with some advantages.

§21. **Need for further railway development.**—Most of these adverse effects, however, are due not to railway construction as such but to the manner in which it was brought about and the undue haste that was displayed in connexion with it. As a matter of fact it is of the greatest importance that, subject to proper safeguards, railway development should progress as fast as possible, in order to expedite the industrial and commercial development of the country. That the country is poorly provided with railways can be seen from the fact that, while Europe (excluding Russia) covers 1,660,000 sq. miles and has 190,000 miles of railways, India and Pakistan contain 1,803,000 sq. miles of country and have but 40,518 miles of railways (1946).

Particularly when judged by the standard of population, India is much worse provided with railway facilities than are many other countries. It would of course be absurd to contrast the railway mileage of agricultural India, with her vast mountain ranges, great river estuaries, widespread deserts and barren places,

with that of a highly industrialized, compact country like England, where almost every square mile is made to contribute something to the national income. Further, it must be remembered that the need for communications in India can most effectively and cheaply be met in many cases by mechanized road transport and water carriage in preference to railways. But even so there is undoubtedly great need and scope for extension of railways. It is also essential that railway industries should be developed and fostered along with railway construction. This is a matter which has so far been almost entirely neglected. The danger of India's dependence on outside supplies for railway materials and even for ordinary repairs was fully disclosed during the war of 1914-18. Steps should therefore be taken to put an end to this dependence. It is expected that by the end of 1950, India will start turning out her own locomotives and that the Chittaranjan Factory will go into full production by 1952-3. An agreement was signed in December, 1949, between the Government of India and the Locomotive Manufacturers Co. Ltd of England by which the latter undertakes to supervise production at Chittaranjan for the next five years. In return, the Government has agreed to place an order for 200 locomotives with the Locomotive Manufacturers Co. The total estimated cost of the Chittaranjan project is a little over Rs. 14 crores for workshops, etc., and Rs. 5·5 crores for the staff colony and welfare work. It is designed to build 120 steam locomotives and 50 spare boilers every year. Otherwise also, in the general interests of industrialization, the case for indigenous railway industries is clear.

Road Transport

§22. **Recent road history.**—The unsatisfactory state of road transport in India about the middle of the last century has already been alluded to. The East India Company, being mainly a commercial corporation, neglected an important duty of a civilized Government in that it took little interest in road-making. Whatever limited progress was made was due to the initiative taken by individual administrators like Lord William Bentinck, who revived the idea of a highway connecting the north of India with Bengal, resulting in the construction of the Grand Trunk Road linking Peshawar with Delhi and Calcutta. The little importance attached by the Company to the road needs of the civil population is shown by the fact that roads were then placed in charge of Provincial Military Boards instead of being entrusted to a special Public Works Department.

India, however, entered upon a new epoch of road-making during the time of Lord Dalhousie, who, in addition to his active interest in the promotion of railways, initiated a more vigorous road policy, and for this purpose, over and above the central Public Works Department, there were created in 1855 similar departments in each province replacing the old Military Boards. A second factor which has promoted road development during the last ninety years or so has been the influence of railways. As railway construction proceeded apace it became increasingly necessary to build roads to feed the railways rather than to compete with them, 'leading to a demand, which remains today far from being completely satisfied, for bridged and metalled roads at right angles to the railways and giving access to them in all the seasons of the year'.[1] The extension of railways and the

[1] *Agricultural Commission Report*, p. 370.

intimate financial interest of the Government in their profitable working has, however, led to a certain neglect of roads, especially of trunk roads where they run parallel to the railways.[1] The progressive policy of Lord Mayo and Lord Ripon with regard to local self-government, under which local control over local affairs was provided, acted to some extent as a stimulus to road development. The total effect of all these factors is reflected in a considerable activity in road-building during the last ninety years or so.

§23. The main features of India's road system.—There exist at present four great trunk roads stretching across the country, with which most of the important subsidiary roads are linked. The most famous of the trunk roads is the ancient marching route for armies, known as the Grand Trunk Road, which stretches right across the northern part of the country from Khyber to Calcutta; the other three connect Calcutta with Madras, Madras with Bombay and Bombay with Delhi. These four main roads accounted for about 5,000 out of the 95,054 miles of metalled roads in British India in 1943. Southern India is most favoured both as regards the number and the satisfactory character of its subsidiary roads. The worst-served regions are Rajputana, Sind, parts of the Punjab, Orissa and Bengal. Aridity, sparseness of population, unbridged and unbridgeable waterways, difficulties of the ground and lack of suitable road materials are some of the obstacles. Besides metalled roads there was a very large mileage of *kachcha* (unmetalled) roads in British India (201,414 miles in 1943) some of which provide quite good going for motor traffic during the dry weather. India's road system even before the advent of motor transport was altogether insufficient for her needs.[2] In 1943, the Chief Engineers of the various provinces and important States, met in conference at Nagpur, recommended a programme of improvement of the entire road system and the construction of an additional 400,000 miles of roads. This came to be known as the Nagpur Plan. The Central Government accepted liability for the construction and maintenance of the National Highways outside the States with effect from 1 April 1947. The Provincial Governments as well as the States undertook their own respective contributions to the road development programme as envisaged in the Nagpur Plan. But the actual progress of the proposed development has been very slow and disappointing owing to various causes such as delay in acquisition of land, difficulty of obtaining road machinery, steel and cement, shortage of technical personnel, railway bottlenecks in transporting road materials and latterly growingly acute shortage of funds.

Village roads and the humbler district roads have not only not progressed but

[1] See *Road Development Committee Report*, par. 17.

[2] The Agricultural Commission (1928) pointed out that while there were 80 miles of roads per 100 sq. miles of area in the U.S.A., there are only 20 miles of roads per 100 sq. miles of area in India (*Report*, par. 299). India is still very far from the ideal enunciated by Sir Kenneth Mitchell, when he was Controller of Road Transport, Government of India, who said that no village of 1,000 population and over should be more than half a mile from a public road. The Indian Roads and Transport Development Association suggests the target of a road of not less than 10 feet in width within a mile of every village of 300 inhabitants and over. Even if our 700,000 villages are to have an average of only one mile of road each to connect with neighbouring villages, markets and railway stations the total road mileage will be 700,000 as against the existing mileage of 300,000.

have deteriorated with the increasing traffic of more money crops, growing population and more travel. The deterioration in the case of roads maintained by local bodies is generally attributed to their limited resources. According to Sir Kenneth Mitchell, however, it is due more to administrative mistakes: the administrative machine of local self-government must be pronounced a failure so far as this particular kind of work is concerned. Although the plea of inadequate resources is partly true, local bodies have not always shown wisdom in spending the money budgeted for roads. In any case, according to Sir Kenneth the financing of post-war development and the overtaking of years of neglect will be altogether beyond the existing and potential resources of local bodies. He therefore proposes that district roads should be transferred to expert Provincial Highway Departments and that local bodies should cease to be responsible for either their construction or maintenance.

The astonishing rapidity with which motor traffic—both the private car and especially the public motor omnibus—has sprung up all over India in recent years has created an entirely new range of problems of road construction and maintenance. It is true that the motor lorry has scarcely affected the use of the bullock-cart for the conveyance of agricultural produce and manufactured articles, even over long distances, owing, *inter alia*, to the difficulties presented by the hopeless condition of many roads and the presence of many unbridged rivers even on the arterial roads, and the competition of railways. But as these difficulties are overcome, we may expect a considerable part of the goods traffic to be captured by mechanized transport. This development is especially likely in hill tracts where railway construction could not be economical, but where a motorable road is possible. In the vicinity of large towns, again, motor transport has another opportunity in respect of carriage of perishable goods.

§24. **Need for more roads.**—As the Agricultural Commission remark: 'Transportation is an integral part of marketing, and modern commercial development tends everywhere to enhance the value and importance of good road communication.' The provision of good transport is the surest way of stimulating agricultural production and raising the standard of life in rural areas by facilitating the substitution of commercial for subsistence farming. It will lessen the constant strain on the health and stamina of draught animals and increase their efficiency. It will reduce the wear and tear of the vehicle and will cause considerable saving in time. Roads will be of particular assistance to the development of industries connected with the preparation of agricultural produce for export or internal consumption. They will also facilitate the decentralization of industries, the undue concentration of which at present is a source of many of their difficulties, especially in connexion with labour-supply and housing. They will bring within the bounds of possibility the establishment of 'garden factories' in a rural environment. Lastly, the large forest wealth of India can only be exploited effectively with the help of suitable road transport.

§25. **Roads versus railways.**—Though a considerable expansion of railways has been planned for the near future, it is hardly likely that for many years to come this vast country will be provided adequately with railways as judged by its needs and the standards attained in Western countries. In order to open up the hinterland and

link it with the large industrial centres and ports, reliance will have to be placed to a very great extent on a network of arterial and feeder roads. No doubt the construction of roads involves heavy initial expenditure and further expenditure for maintenance and repairs from year to year. The railways are, however, an even more costly form of inland transport, at any rate for local traffic. For relatively lighter traffic and for short distances the road is more suitable, and it can be constructed almost anywhere at a considerably lower cost than a railway.[1] At the same time it must be remembered that conditions of weather in India, often alternating between extreme dryness for many months of the year and continuous and heavy rainfall concentrated in a short period, render the maintenance of roads capable of carrying heavy motor traffic extremely expensive, and the advantage here would probably be on the side of railways. Road transport has an advantage over railway transport, in that it does not require stations, sheds, signals, sidings, etc.; nor does it involve any loss of time at the termini with their special charges; nor encounter problems of carrying half-empty wagons, and of allowing a good deal of rolling stock to remain idle, and so forth. The apparent cheapness of road transport is in some measure due to the fact that the heavy cost of maintaining roads suitable for mechanized transport has to be borne at present mostly by the general taxpayer, while the railways themselves have to pay for the whole cost and upkeep of their permanent way. But even if motor traffic is made to bear a substantial part of the charge of maintaining the roads, road transport will sometimes retain the advantage of greater cheapness. This applies, as already stated, to lighter traffic and short journeys. On the other hand, the railways will hold their own and will be a more convenient and economical form of transport for heavy loads and longer distances, owing, among other things, to their much smaller running charges. Over a certain part of the field, roads and railways are alternative and competitive. Over another not insignificant part, however, they are complementary and mutually helpful. This point has been well put thus: 'The road system links up the cultivator's holding with the local markets and the nearest railway station, while the railway provides the connecting links between the area of production and consumers at a distance, and between the manufacturer in the town and the cultivator who purchases his ploughs, his fertilizers, or his cloth. Without good roads and sufficient roads, no railway can collect for transport enough produce to render its operations possible, while the best of roads cannot place the producer of crops in touch with the consumer.'[2] There is therefore no reason to suppose that the national investment of some Rs. 800 crores in railways is likely to be jeopardized by the extension of road communications. No doubt, a certain amount of competition between railways and roads cannot be avoided, not only in the neighbourhood of large cities and suburbs, but also in other parts of the country where motor services run parallel to or short-circuit railway routes, as between Poona and Ahmednagar. The general policy adopted by the railway administration is to afford to the public an equal or better service than road transport can give, while taking full advantage of the additional business brought to railways

[1] In days to come the aeroplane will have no rival for the quick transport of light and valuable goods.

[2] *Agricultural Commission Report*, par. 312.

by such motor transport as can act as feeder or distributor. Motor services have often been started because the railways have failed to meet the public demand in some way or other. Their competition has thus been sometimes advantageous from the public point of view in so far as it has forced the railways to attend better to the needs of the public.

§26. **Counter-measures to meet road competition.**—Among the methods of meeting road competition are railway omnibus services, sentinel coaches and shuttle trains, time-table adjustments, cheap return tickets, third-class zone season tickets, quotation of special terms for marriage parties, special trains at concession rates, greater publicity for railway services, facilities and charges.[1] The Wedgwood Committee recommended a series of counter-measures for dealing with road competition.[2] As regards passenger traffic, they favoured faster passenger trains, better connexions, more intensive services, and improved amenities for lower-class passengers. They deprecated any wholesale reduction of fares to meet road competition. Fares should only be reduced locally to meet specific cases of diversion or threats of diversion. Indian railways should do more to develop traffic through booking agencies. It may be noted here that the commercial side of railway administration has been strengthened in recent years as recommended by the Wedgwood Committee. As regards goods traffic, that Committee recommended faster goods trains, more expeditious handling of goods, simplification of clerical formalities, development of collection and delivery services, use of containers and of railway-owned refrigerator trucks, etc. As modern conditions demand quicker transit, it is desirable for railways to sacrifice full wagon-loads or train-loads in the interest of better service. A general reduction of rates to meet road competition would involve the railways in a heavy loss of revenue. The railways should, therefore, continue their policy of judicious reductions in individual rates.[3]

§27. **Transport co-ordination policy.**—While it may thus be difficult to arrange for a policy of co-ordination between the two forms of transport, it is possible to adjust new programmes of road and railway extension in such a way that roads may serve rather as feeders of the railways than competitors for such traffic as the railway is capable of handling more efficiently and economically, and to avoid in India the senseless and wasteful competition between rail and motor traffic witnessed in many European countries. Funds available for capital expenditure on transport should be largely devoted to the construction of roads in such a way as not to duplicate existing transport facilities, precedence being given to the construction and development of non-competitive roads in areas with little or no transport facilities. Careful co-ordination is necessary to ensure the allocation to each different form of transport service of work for which it is best suited. The Mitchell-Kirkness Report recommends for this purpose the creation of a Central Advisory Board of Communications in the provinces and Divisional Com-

[1] *Report of the Railway Board on Indian Railways* (1939-40), pars. 62-4.

[2] For particulars regarding the action taken by the Government of India on the various recommendations contained in the report of the Wedgwood Committee see *Railway Budgets* (1938-9), pars. 8-10 and (1939-40), pars. 9-17.

[3] *Indian Railway Inquiry Report*, pars. 169-89. See also §28 below.

mittees in the Commissioner's Divisions. This Report was the result of an inquiry which was conducted during 1932-3 by a small committee of two officers, Mr K. G. Mitchell (now knighted), Road Engineer with the Government of India, and Mr L. H. Kirkness, Officer on Special Duty with the Railway Board, into existing road and railway competition. Their Report suggests a better control of motor transport as one of the methods of making this competition fair.[1] The Road-Rail Conference which was convened in 1933, in pursuance of the recommendations of the Mitchell-Kirkness Committee, adopted resolutions relating to questions of co-ordination of effort between the various authorities responsible for the development and control of the different forms of transport so as to reduce uneconomic competition between them. Among other methods the Conference favoured the removal of the statutory embargo on certain railways operating road motor services, the grant of monopolies of road transport services with a view to developing rural services, and the creation of machinery at the centre and in the provinces designed to secure the co-ordination proposed. The Railway Act was accordingly amended in September 1933, empowering railways to run motor services in conjunction with rail transport. A Transport Advisory Council consisting of the Ministers in charge of roads in the various provinces or their representatives, with one or two Council advisers, was also formed (1935). Its function was to arrive at a considered statement of road policy which might be generally acted upon by the provinces for the furtherance of the co-ordinated development of road, rail, and other forms of transport—a purpose of the very highest importance for the economic development of the country.[2] The establishment (1937) of a new Department of Communications rendered easier the adoption of a policy of transport co-ordination in the country. The new Department (since 1947, Ministry) has taken over railways, posts and telegraphs, civil aviation, broadcasting, meteorology, roads, ports and inland navigation.

§28. **Wedgwood Committee on rail-road co-ordination and after.**—The Wedgwood Committee reported that regulation of road transport by Provincial Governments was inadequate and that conditions were chaotic. The policy followed by the Provincial Governments encouraged an unorganized and inefficient type of road transport whose competition tended to cripple the railways without providing a trustworthy service on the roads; whilst on the other hand, the control exercised by the Central Government on the expenditure on roads from the Road Fund (see §§32-4 below) could only be made effective by delaying or restricting the provision of an adequate road system, which is a public need of the first order quite irrespective of the railways. In this way, a continuance of the present policy seems certain to give India the worst of both worlds—unprosperous railways and inadequate roads.[3] Effective co-ordination can only be brought about by operating both road and rail transport as public services. The Committee did not agree with the view that regulation of road transport is advocated merely for the sake of protecting the railways. Proper regulation of road transport is necessary not only in the interest of safety but also to guide its own development

[1] See *Mitchell-Kirkness Report*, p. 24.

[2] For an instructive discussion of the question of co-ordination, see S. K. Guha, *Problems of Transport Co-ordination in India.*

[3] *Report*, par. 138.

along sound and economic lines. It is also desirable that the railways should be protected against unfair and uneconomic inroads by a new competitor. The regulation of roads should be carried out by Provincial Governments in accordance with uniform principles enacted by the Central Government. No restrictions, however, should be imposed on road transport which would unfairly hamper its development. Measures of regulation should be common to buses and lorries in the interest of public safety. Licences should be issued in accordance with public need so as to avoid excessive provision and maldistribution of road transport facilities. Passenger services should be regulated by a system of route-licensing, and time-tables and fares should be fixed. The Committee recommended a system of regional licensing for goods vehicles and suggested statutory provision in order that goods rates might be regulated at some future date. The same system of regulation should be applied to private lorries as to public lorries. Police control for enforcing provincial rules should be strengthened and the provinces should aim at uniformity in the taxation of motor vehicles.

The Wedgwood Committee strongly recommended participation in road transport by railways and to this end proposed that railways should have full powers to run road services, to invest money in or enter into working agreements with road transport undertakings and to arrange road transport services through contractors. The railways should examine the possibility of passenger and road services and place their proposals both as regards competitive and feeder services before the Provincial Governments. The railways in India are gradually implementing these recommendations. Finally the Committee urged the importance of voluntary co-ordination between railways and the more responsible elements in the road transport industry.[1]

§29. **Regulation of road motor traffic.**—The Motor Vehicles Act of 1939 supersedes the earlier Act of 1914 which was found inadequate to deal with the rapid growth of motor transport.

The Act has two main aspects, (i) regulating and (ii) co-ordinating. Its general scheme is that control of transport vehicles carrying passengers or goods for hire or otherwise should be in the hands of regional transport authorities constituted for specified areas within the province, and that for the purpose of co-ordination, hearing appeals, etc., there should also be constituted a provincial transport authority for the whole province. A person who has any financial interest in any transport undertaking cannot be appointed, or continue as, a member of any such transport authority. All motor vehicles must be covered by a permit issued by the regional transport authority of an area, and the holder should be required to observe certain well-recognized conditions, such as satisfactory maintenance of the vehicle, the observance of prescribed speed limits, and the avoidance of overcrowding the vehicle or overworking the drivers.[2] The constitution of the provincial authority is permissive. It may be required for purposes of co-ordination, or to settle differences between regional authorities, or to increase control over through routes.

[1] *Indian Railway Inquiry Committee Report*, pars. 135-67.

[2] Their hours of work are restricted to 9 in one day, and 54 in the week. Provision has been made for a minimum rest interval of half an hour after five hours of work.

In granting permits for motor buses and taxis the transport authorities are required to bear in mind certain general guiding principles, viz. public necessity and convenience, the prevention of uneconomic competition, and the suitability of the roads to carry those forms of transport. In the case of public goods traffic, the principle adopted is that, while the transport of perishable goods by road over short distances, in order to avoid the delay and damage caused by terminal transhipment, should not be interfered with, long-distance traffic should be left primarily to railways. The necessary control over road transport is vested with the Provincial Governments. It is provided that a route-permit holder, in return for the security given to him against unreasonable competition, should maintain a regular service, i.e. have the responsibility of a public utility company. Power is given to the regulating authorities to fix minimum and maximum rates for traffic on the roads.

A notable feature of the Act—and the one which has caused the most acute controversy—is the provision relating to compulsory insurance of motor vehicles in respect of third party risks. This provision, which came into operation on 1 July 1946, may be welcomed in view of the numerous motor accidents on roads in this country. It is essential for enforcing the social responsibility of public carriers.

It is provided that motor licences should be valid throughout India, without detriment to the right of a province or State to fix its own motor taxation. Applicants for new licences are required to pass a special prescribed test.

Although some of the features of the new Act have given rise to controversy it is non-contentious in principle and has been rightly described as a 'highway code'. There is a welcome and growing recognition of the necessity of evolving order out of chaos and of devising measures for the safety and convenience of the public and of the development of a co-ordinated system of transport.

§30. **Indian Road Development Committee.**—The rapid extension of motor traffic in India has led to a growing realization by the Central and the Provincial Governments of the necessity of a comprehensive road programme to co-ordinate local programmes and evolve a common policy. Road Boards have been established in Bombay, Madras, the Punjab, and the United Provinces. These Boards are mainly advisory.

In April 1945, the Government of India moved a supplementary demand to enable railways to invest in bus companies on certain roads running parallel to railways. But before granting this demand the Legislative Assembly insisted on a clear statement of the policy which Government wished to adopt in respect of rail-road co-ordination. Government accordingly issued a White Paper in January 1946 explaining that their policy was to develop both forms of transport not as competing rivals but as complementary to each other. Where rail and road services were parallel to each other and there was danger of cut-throat competition, the most satisfactory solution of the problem would be achieved by bringing about a fusion of financial interests among the parties concerned. It was therefore proposed to start joint motor bus companies in which the existing bus-owners, the railways and the Provincial Governments concerned should all have a share. These joint companies were to be administered by a Board of Directors and no

Managing Agents were to be employed. Several Provincial Governments attempted to put this scheme into effect but in doing so some of them violated in spirit and letter the general instructions laid down. A committee appointed by the Central Legislative Assembly to inquire into the progress of rail-road co-ordination noted the various irregularities in implementing the scheme and came to the conclusion that the actual establishment of the companies should wait till popular ministries were formed in the Provinces.

The Assembly however now took up a wholly hostile attitude towards the whole scheme and turned down the demand for a grant made in order to enable railways to participate in it. The position now is that while nationalization of road transport appears to be the settled policy of the Provincial Governments they have not yet evolved a clear-cut policy on the question of co-ordination.

§31. **Road finance.**—As the Indian Road Development (Jayakar) Committee (1927) observed, 'road development in India is passing beyond the financial capacity of Local Governments and local bodies, and is becoming a national interest, which may, to some extent, be a proper charge on central revenues'. The central revenues benefit from the development of roads, not only through enhanced railway receipts, but also through customs and excise receipts from motors and motor spirit, which are rapidly expanding. A well-balanced scheme of motor taxation should include duty on motor spirit, vehicle taxation, and licence fees for vehicles plying for hire; and the proceeds should be spent on road development. Reclassification of roads should be made so as to transfer some of the local roads to the category of arterial roads, and thus reduce the burden on local bodies and enable them to devote more attention to feeder roads and roads of purely local importance. As the Road Committee pointed out, the iniquity of causing the smaller units of government to bear all the cost of main-road improvements seems to be recognized all over the world. The local bodies also require more liberal financial assistance from provincial funds. The adoption of the above recommendations made by the Road Committee would indirectly benefit village roads by the release of provincial revenues and local funds, which are now being spent on main roads to meet the requirements of motor transport. The Road Committee also favoured contributions by the railway administration towards the construction and maintenance of feeder roads. The Committee deprecated the levy of road tolls on any traffic (except tolls on bridges where a definite service is provided to replace a ferry or a bad river-crossing) as obstructive to a rapid form of road transport and as causing harassment to traffic of all kinds. They should be replaced, where necessary, by a less vexatious form of taxation. The Agricultural Commission recommended the revival of the old system of corporate labour of the village community which might receive financial assistance from the Government, provided it was prepared to do its part of the job.

The Agricultural Commission expressed the view that the policy of road development would be much better carried out if, instead of relying solely on current revenues, loans were raised for financing road programmes. They held that in view of the quasi-permanent character of roads and the works connected with them, the annual amount required for the amortization of provincial loans raised for this purpose would not be a heavy charge on the resources of a province

for the upkeep of local village roads.[1] The Road Committee held that the propriety of raising such loans must be decided by each local Government for itself according to its circumstances. They deprecated large schemes of road expansion financed by loans, for the service of which provincial revenues might be mortgaged for long periods while other departments of the Government, scarcely less important, might be starved. They recommended that only construction or reconstruction should be financed from loans; that loans should be for short periods; that there should be revenue clearly in sight to cover not only the interest and sinking fund charges, but also the cost of maintaining the road when constructed, and that construction from loans should preferably be confined to the more permanent parts of a project such as bridges, the life of which can be estimated with fair accuracy for the calculation of the sinking fund, while the cost of maintenance is small. The Road-Rail Conference of 1933 recommended that a comprehensive plan should be drawn up with a view to examining the possibility of development of both main and subsidiary roads from loan funds within the limit of the resources available for maintenance. The twelfth annual general meeting of the Indian Roads and Transport Development Association Ltd, held in 1940, advocated a new road policy with proper financial arrangements for the provision of roads and their maintenance. The contrast between the methods of financing railways and roads was pointed out. Whereas the railways had been built and equipped out of borrowed money or share capital, roads had in the main been built out of revenue. It was really impracticable to make adequate provision for roads except by using borrowed monies for the purpose.

§32. **The new road policy.**—In accordance with the principal recommendation of the Road Committee, the Indian Finance Act of March 1929 introduced an increase in the import and excise duties on motor spirit from 4 to 6 annas per gallon (from which an additional revenue of Rs. 94 lakhs was received in the year 1929-30). Sir B. N. Mitra tabled a resolution in the Assembly on 11 September 1929, in accordance with the recommendations contained in paragraphs 70 to 79 of the Road Committee's discussions. The principal features of the Convention embodied in the above resolution were as follows:—(i) To ensure some continuity in road programmes, the increased duties on motor spirit should be maintained for a period of five years in the first instance. (ii) The proceeds of the additional duty during the same period should be allotted as a block grant for expenditure on road development to be credited to a separate road development account, the unexpended balances of which should not lapse at the end of the financial year. (iii) The annual grant was to be divided as follows:—(*a*) The Government of India was to retain ten per cent as reserve for two years ending 31 March 1931, and the position would be reviewed thereafter. From this reserve special grants might be made, where for some reason there was need for special aid, for example for projects beyond the resources of local Governments or those that concerned more than one province or State, or a bridge over a river on a provincial or State boundary. (*b*) Out of the remainder (1) an allotment was to be made among the provinces in the ratio of the consumption of petrol in each province to the total consumption in India

[1] *Agricultural Commission Report*, par. 306.

in the preceding calendar year; (2) the balance representing the consumption of petrol in minor provinces, administrations and Indian States was to be allotted as a lump sum to the Government of India. (iv) Grants were to be made to each province for expenditure on schemes approved by the Governor-General-in-Council with the advice of the Standing Committee for Roads. (v) A Standing Committee for Roads was to be constituted every year, consisting of certain elected and nominated members of both the Houses of the Indian Legislature, under the chairmanship of the member of the Governor-General's Executive Council in charge of the department dealing with roads. This Committee was to advise the Governor-General-in-Council on all matters relating to roads including central research on roads, and any action to be taken by the Government of India on the proceedings of the periodical road conferences. (vi) All proposals for expenditure from the annual grant or its accumulated balance were to be submitted for approval to the Finance Sub-Committee, consisting of the Chairman of the Standing Committee for Roads and of its members who were also members of the Legislative Assembly.

This Convention was adopted by the Assembly at the Delhi Session (February-March 1930) for a period of five years.

As recommended by the Road Committee a certain amount of co-ordination between the Centre and the Provinces has been effected through periodical road conferences of representatives of the Government of India and local Governments, who meet from time to time to exchange views on matters of common concern. In accordance with the Committee's recommendation a Road Engineer to the Government of India, who also acts as secretary to the Road Conference, has been appointed.

§33. **Financial position of the road account.**—With the levy of a surcharge on petrol, the share of the petrol duty available for the Road Fund was increased from 2 annas to 2½ annas per gallon with effect from 1 October 1931. The total revenue during the first five years of the Road Development Account amounted to Rs. 518 lakhs. Up to the end of March 1944 the Fund had received about Rs. 21 crores and after transferring nearly Rs. 4 crores to the Reserve,[1] the sum available for distribution to the Provinces, States and minor Administrations was about Rs. 16 crores, excluding Burma's share prior to separation. The total unspent balance to the credit of the Road Fund on 1 April 1944 was Rs. 232·35 crores.

§34. **New road resolutions.**—(i) The probationary five years for which the road account was first instituted came to an end in 1933-4. A new resolution governing the road account was adopted by the Central Legislature in April 1934, which placed the account on a more or less permanent basis. It increased the reserve at the disposal of the Government of India from ten to fifteen per cent to enable them to deal more liberally with the less developed provinces. It provided for the service of loans for road development and in special cases for the maintenance of roads constructed from this account or from loans as admissible charges on the account.

(ii) On the recommendation of the Transport Advisory Council a new Road Resolution regarding the allocation of grants from the Road Fund to the provinces

[1] By the Road Resolution of February 1937 referred to in §34 the percentage of the annual grant to be set aside for the Reserve was raised from 10 to 15 per cent.

was passed in February 1937 by the Central Assembly. The main changes were as follows: (*a*) The shares allocated for expenditure in the Governor's Provinces were in future to be retained by the Governor-General-in-Council until they were actually required for expenditure in order to ensure prompt utilization of the money placed at the disposal of the provinces. (*b*) The Central Government was empowered to resume the whole or any part of the sums which it might hold, for expenditure in any province if without reasonable cause the province delayed utilizing its share in the Road Fund for road development. (*c*) But the most important change was effected by the clause which authorized the Governor-General-in-Council to resume the share of a province if it failed to take such steps as he might recommend for the regulation and control of motor vehicles. This last provision was resented by the provinces as amounting to unwarranted interference in their road policy by the Central Government, in order to protect the budgetary position of the railways. The Central Government argued that the object of the resolution was to secure a balanced system of communications. (*d*) The provision in the earlier resolution allowing the use of the Road Fund for defraying the charges on road loans was discontinued (without prejudice to existing commitments) in view of the impending inauguration of Provincial Autonomy.

Although this resolution on the Road Fund indicated the possibility of a clash between the Central Government and the provinces, no great friction was anticipated since under the financial scheme of Sir Otto Niemeyer for assigning a share of the income-tax by the Government of India to the Provincial Governments, the provinces would be interested in the solvency of the railways and in taking measures to prevent motor transport from seriously damaging railway earnings. (See ch. xii).

The original resolution dealing with the disposal of the Road Development Account was thrice amended, the resolution at present in force having been passed by the Dominion Legislature in November 1947. As a result the special tax on petrol, introduced in 1929, shall continue to be levied and the proceeds, after retaining a reserve of 15 per cent for administration, research and special grants-in-aid, shall be allocated for expenditure in the different Provinces, Unions, etc., in the ratio of their petrol consumption. These sums may be spent on all matters connected with roads apart from ordinary upkeep or maintenance.

Water Transport

§35. (i) **Inland waterways.**—The discussion of the subject of water transport may conveniently fall under two broad divisions: (i) inland waterways, and (ii) marine transport.

India is not favoured by nature in the same way as, say, England with rivers which serve the purpose of natural waterways. We have already noted the contrast in this respect between the rivers in northern India and those of the peninsula.[1] It is stated that there are about 26,000 miles of navigable waterways in connexion with the great river systems of northern India and Pakistan. The Indus, and its tributaries the Chenab and the Sutlej, the Ganga (Ganges), and the Hooghly and the Brahmaputra, are navigable by steamers all the year round, or for the greater

[1] Vol. I. ch. ii, §10.

part of the year, for hundreds of miles above their mouths or above the heads of navigable canals traversing their deltas.

The rivers in the peninsula do not, however, lend themselves to navigation. According to the season they either flow in torrents or are reduced to mere pools or strings of water amidst a wilderness of sand or deep gorges, making navigation impracticable. The rocky beds and swift floods of some of the rivers, like the Narmada and Tapti, are insuperable obstacles to navigation. The Mahanadi, the Godavari and the Krishna are indeed navigable in their upper reaches, but the traffic on them is not very considerable.

In addition to these somewhat restricted facilities for inland river traffic, there are all round the coast innumerable small rivers, creeks and backwaters affording facilities for water transport which are fully utilized by small indigenous craft; but outside the zone of such operations inland navigation is practically confined to the deltas and valleys of the great rivers which form the natural waterways of the country.

Inland navigation was largely resorted to in the old days and there was a considerable volume of river traffic at the time of the Mauryan and the Mogul empires. For example, the Ganga was the great natural highway of commerce, and on its banks flourished towns like Mirzapur, which was a great centre of trade between central India and Bengal. Since the advent of railways, however, inland navigation has received a set-back. As the Industrial Commission pointed out: 'In the absence of a representative specially charged with their interests (that is, those of the existing waterways) the vested interests of the railways have prevented waterways in India from receiving the attention that has been given to them in other countries with such satisfactory results.'[1] The Acworth Committee made the same observation, and they cite the case of the river port of Broach in Bombay and the Buckingham Canal in Madras in support of their contention.

At one time there was a good deal of agitation in favour of navigable canals. Sir Arthur Cotton, 'the architect of the magnificent Kaveri and Godaveri works', prepared an ambitious scheme of navigable canals, which was put before a Parliamentary Committee in 1872. He contended that water-carriage facilities were more suitable for India and less expensive than railways and had the further advantage that they could sometimes be combined with irrigation. The scheme was suffered to be dropped, however, because of the heavy expenditure (£30 million) it entailed, and even more because it was difficult for Englishmen to understand the value of canals in India, as experience in their own country seemed to decide the case in favour of railways. The opposition on the part of the railways in India was another factor.

The construction of navigable canals, either in conjunction with irrigation or for transport pure and simple, did indeed appear particularly attractive at a time when the railways were a losing concern. Much of the enthusiasm, however, was lost with the turn in the tide and the commencement of railway profits at the beginning of the present century. There are only a few navigable canals today, such as the Ganges Canal from Hardwar to Cawnpore, and the Buckingham Canal parallel to the east coast in Madras. The numerous irrigation canals are for the most

[1] *Industrial Commission Report*, par. 279.

part not suitable as waterways. The two types of canal cannot often be well combined together. Generally speaking, navigation cannot be maintained during the season of short supply of water without detriment to irrigation. Irrigation canals are moreover usually shallow and circuitous in their course and pass through sparsely populated rural regions to serve the needs of cultivation. Canals for navigation on the other hand, must be deep and pass through industrial and commercial centres in order to attract a sufficient volume of business. Conditions are, however, more favourable in the deltaic tracts of Bengal, Orissa, Sind and Madras.

In spite of the physical limitations imposed upon inland navigation in India there is still much scope for the extension of inland navigation. The Industrial Commission recommended that the Government of India should take up the question and see to it that the railway and waterway administrations work together harmoniously for those parts of the country which are served by both and that the proposal of forming a Waterways Trust should receive careful consideration.[1] Inland waterways, properly developed, would relieve congestion in the railway system and serve the needs of small-scale transport in the country. It may also be possible to adapt at least some of the irrigation canals to the needs of navigation. Regulation, development and control of the rivers and waterways through provincial and inter-provincial commissions for the benefit of agriculture and industry was suggested by the National Planning Committee (1938).[2] The Central Waterways Irrigation and Navigation Commission is carrying out an exhaustive investigation into the possibilities of extending inland navigation by means of new construction or resuscitation of old waterways. As most of the major rivers of India pass through several Provincial and State jurisdictions, the creation of a federal authority or special regional authorities like the T.V.A. in the United States will be necessary for ensuring a satisfactory development of our waterways.[3]

§36. (ii) **Marine transport.**—As regards external water transport, although India does not possess the advantages of England with her indented coastline and natural harbours, she occupies a maritime position of considerable importance. As S. N. Haji remarks: 'A country set like a pendant among the vast continents of the Old World, with a coast line of over 4,000 miles and with a productiveness of numerous articles of great use, unsurpassed elsewhere, is by nature meant to be a seafaring country. Her ports are adequate in size and numbers to meet the various requirements of her products.'[4]

Perhaps the picture is drawn here in excessively bright colours and does not give sufficient weight to India's deficiency of natural harbours. At the same time, as already pointed out, she may well aspire to become one of the principal carriers of the world on account of her extensive seaboard and her favourable geographical position. Till about the beginning of the nineteenth century, India could be spoken of as a great seafaring country. 'Ship-building was in so excellent a condition in India that ships could be (and were) built which sailed to the Thames in company

[1] See Dutt, op. cit., pp. 360-77.

[2] *National Planning Committee*, Series No. I, p. 14. The Inland Steam Vessels Act, (1930) may be cited as a small attempt to develop Indian inland water transport by fixing maximum and minimum rates.

[3] See *Eastern Economist*, 28 March 1947, pp. 500-11, article on 'Inland Navigation'.

[4] *Economics of Shipping*, pp. 365-6.

with British-built ships and under the convoy of British frigates. The Governor-General in 1800, reporting to his masters in Leadenhall Street, London, said: "The port of Calcutta contains about 10,000 tons of shipping, built in India, of a description calculated for the conveyance of cargoes to England." The teakwood vessels of Bombay are greatly superior to the "oaken" walls of old England.'[1]

Speaking of the period at the death of Akbar, Moreland points out that the great bulk of the commerce in the Indian seas was carried in ships built in India, and that India had also great passenger ships much larger than any in contemporary Europe with the exception of the ships built by the Portuguese.[2]

The introduction of iron-built ships, however, deprived India of her differential advantage in respect of timber. The rapid improvement in naval architecture and the introduction of mechanized sea transport, the jealousy of the British shipping interests and the operation of the British Navigation Acts, which were applied to India as she came more and more under British control, may be regarded as the chief causes which led to the decay of Indian shipping.[3]

§37. **The difficulties of Indian enterprise in shipping.**—The total value of our coastal trade in 1937-8 (after the separation of Burma from British India) amounted to Rs. 87 crores. This value, and the tonnage engaged in the coasting trade of India, are capable of extension if harbour facilities are improved and the co-operation of railways ensured. The growth of an Indian mercantile marine controlled predominantly by Indians ought to stimulate the coastwise trade, as also the present Government policy of improving harbour facilities, evidenced by the development of Vizagapatam and Cochin.

The total value of the sea-borne trade to India in merchandise and treasure was estimated at Rs. 639·85 crores for the inter-war average. It has no doubt declined in recent years but it still remains considerable. Its total value in 1944-5 amounted to Rs. 429 crores. The total tonnage of entries and clearances of vessels into and from the maritime provinces of India amounted to 22,100,000 in the year 1938-9. It has been estimated that the share of Indians in the coasting trade amounts to 40 per cent, and in the oceanic trade to about 4 per cent. In 1938-9 the percentage share of British vessels engaged in the foreign sea-borne trade which entered at ports in British India was 66 of the total tonnage. The British Indian share was only 3·6 per cent, foreign 29·8 per cent and indigenous craft 0·6 per cent.[4]

[1] W. Digby, *Prosperous British India*, pp. 85-6.

[2] 'The Indian may not have sailed his ships into seas no other keels had ploughed, but he did surprise Vasco da Gama by his knowledge of the oceans, by his ingenuity at directional instruments and his skill in ships.'—J. E. Castellino's article, 'Planning in Transport', in the *Eastern Economist*, 3 December 1943.

[3] See Digby, op. cit., pp. 87-9, and Malaviya's Minute of Dissent to the *Industrial Commission Report*, pp. 299-300.

[4] 'Of late, much attention has been focussed on the Muchwa or the Patnar, the small handycraft operating along the coasts of India. In August 1942 a committee was appointed to inquire into the possibilities of developing and organizing on a more efficient basis the greater use of sea-going country craft. It seems incredible that 4,800 craft ply on the west coast of India and that the average tonnage per craft is as high as 42. The estimate places the amount now transported by this form of transport at a figure of 1½ million tons per annum. The establishment of Country Craft Organization Offices with Intelligence Officers at the various ports, the rationalization of the traffic by balancing requirements of

The corresponding shares of vessels which cleared at ports in British India were 66·6, 3·4, 29·3 and 0·7 per cent respectively. All this means the loss of a highly remunerative branch of business to the country.

The British India Steam Navigation Company, which is a British concern, has dominated for nearly a hundred years the coastal as well as the overseas trade of India. All the companies; Indian as well as British, engaged in the coastal traffic of India have formed themselves into what is called a Conference for the division of the trade and its regulation with a view to preventing rate wars. The Conference being dominated by foreign interests, its policy has been to suppress indigenous shipping enterprise. The two most important grievances of Indian shipowners have been: (i) the deferred rebate system[1] and (ii) rate wars.[2]

§38. **Deferred rebate, rate wars, etc.**—The deferred rebate system has been explained thus: 'The shipping companies issue a notice or circular to shippers informing them that, if at the end of a certain period (usually four or six months) they have not shipped goods by any vessels other than those dispatched by members of the Conference, they will be credited with a sum equivalent to a certain part (usually ten per cent) of the aggregate freights paid on their shipments during that period, and that this sum will be paid over to them, if at the end of a further period (usually four or six months) they have continued to confine their shipments to vessels belonging to members of the Conference. The sum so paid is known as deferred rebate.'[3] This system is designed to ensure the continued 'loyalty' of the shipper to the Conference, and deprives him of all freedom with regard to the shipping of his goods. It also places a powerful weapon in the hands of the Conference for throttling any indigenous shipping enterprise. The Fiscal Commission strongly recommended legislation on the lines followed in other countries against this system.

As regards the British shipping companies, occupying, as they did, a position of practically unchallenged supremacy, they were further helped by Government patronage in India in respect of mail subsidies and the carriage of Government stores. In addition to the deferred rebate system the foreign shipping rings also use another weapon, namely heavily underselling the Indian competitors with a view ultimately to raising the rates to a higher level than before, after the rivals have been ousted. It is no matter for surprise, therefore, that attempts made by Indian enterprise during the last forty years to enter into the promising field of shipping have, generally speaking, ended in failure, and most of the companies formed for the purpose have been driven into liquidation. Another handicap under which Indian

shipping space with empty vessels and by eliminating delays at ports, and the introduction of sea-cum-rail booking will doubtless enhance the value of this ancient but mobile form of transport. Already measures have been evolved of relieving railways of all traffic between Karachi, the Kathiawar and the Gujerat ports and Bombay, Marmagoa, Mangalore and Cochin. The vexing problem in this connexion relates to the high cost of insurance.' —J. E. Castellino, *Eastern Economist*, 3 December 1943, p. 1047.

[1] For a fuller description of this system and shipping rings, see S. N. Haji, *Economics of Shipping*, ch. v.

[2] In 1938-9 there was an uneconomic 'rate war' between the Bombay Steam Navigation Company and the Indian Companies controlled by the Scindia Steam Navigation Company.

[3] Haji, op. cit., p. 126.

shipping enterprise laboured is the unfair treatment meted out to Indian shipping companies by European insurance companies, which usually put into the second class even those Indian ships which were regarded as first-class risks by experts in London, solely on the ground of their Indian ownership.

Neglect of the comfort of deck passengers, practically complete monopoly of Europeans in the higher appointments and refusal to entertain Indian apprentices and train them for posts as officers and engineers have been among the other grievances against foreign shipping companies.

§39. **The position of the Indian ship-building industry.**—The Indian ship-building industry is in no better position than Indian shipping. It is stated that the number of ships of a hundred tons gross or over built in the world in the ten years before the war of 1914-18 was nearly 17,000, their total gross tonnage being something over 28,000,000. These figures will have to be considerably increased to arrive at the total tonnage of the same description built to date. The total contribution of India, before and after World War I, amounted to only twenty-two ships.[1] Competition with non-Indian ship-builders is only practicable at present for small vessels owing to the cost of bringing out such vessels to India, which is large in proportion to their price. Elsewhere the foreign ship-building yards hold undisputed sway. Until recently there were no suitable ship-building yards in India for large ships, and the few repair-shops that existed were controlled by non-Indians.

§40. **The need for an Indian mercantile marine.**—India possesses sufficient facilities for shipping and ship-building. However, as in the case of other countries like Japan, the United States and Germany, State intervention will be necessary to create an adequate mercantile marine within a reasonably short period. Even England's maritime greatness was due in part to the protection derived from the Navigation Acts, which were in operation for well-nigh two centuries before they were repealed towards the middle of the last century. Most of the recent attempts made by Indian shipping enterprise to contest foreign monopoly, even in home waters, have come to grief for lack of determined State intervention.

The value of a mercantile marine as a naval auxiliary and a second line of defence in times of war is universally recognized, and as India has now laid the foundation of her own navy she cannot afford to neglect this aspect of the question. India's coastal and foreign sea-borne trade is sufficiently large in volume to keep an Indian mercantile marine busy. Her dependence on foreign shipping companies—the inconvenience of which has been brought home particularly during the two world wars—is an element of weakness in her economic position as also in that of the Commonwealth at large. Moreover, the proper development of a mercantile marine will open new avenues of employment to Indians. Navigation, marine engineering and insurance are highly remunerative branches of business, which have so far been monopolized by Europeans.

§41. **The Mercantile Marine Committee (1923).**—The Indian Mercantile Marine Committee was appointed in February 1923, to consider and report what measures were necessary for the promotion of the Indian shipping and ship-building industries. The main recommendations of the Committee were as follows:

(i) In order to provide for both the training and future employment of the

[1] For the various forms of State aid to indigenous shipping and ship-building in other countries, see Haji's pamphlet, *State-Aid to National Shipping*.

officers indispensable for the formation of an Indian mercantile marine, a training ship should be established at Bombay by the Government. (The Government accepted this recommendation and the Royal Indian Marine vessel 'Dufferin', refitted so as to enable her to take in cadets, is now utilized as a training ship for officers and engineers of the Indian mercantile marine.) (ii) For the training of marine engineers provision should be made at the colleges of engineering, and facilities should be given for further experience at sea. (iii) The coastal trade should be reserved for licenced shipping companies, which are to arrange for eventual Indianization as regards ownership and controlling interest. (iv) The question of granting navigation bounties to purely Indian shipping companies in respect of overseas trade to other countries should be favourably considered as soon as a sufficient number of trained Indian officers are available and Indian shipowners have proved efficient in managing and running coastal steamers. (v) Calcutta should be developed as a centre of self-propelled ship-building, being most suitable owing to its vicinity to coal- and steel-producing districts and the greater experience than any other centre which it commands. The Committee recommended that protection should be given to the industry in the form of construction bounties so as to make up the difference between the minimum cost of production in India and abroad, subject to a maximum of twenty-five per cent of the price abroad. (vi) The establishment of a ship-building yard by an Indian company may be aided by the Government by (*a*) cheap loans and assistance in acquiring a suitable site; (*b*) extension of Government and Port Trust patronage on certain terms regarding the cost, and (*c*) legal provision that when such a suitable ship-building yard is completed and established, all ships seeking a licence on the coast should also be required to have been built in India. (vii) Expert assistance from abroad for ship-building should be invoked to start with. India must, however, eventually establish schools and colleges in the country itself for the study of naval architecture as in England. In the meantime the colleges of engineering should provide for additional post-graduate courses in naval architecture.

§42. **The Bill for reserving coastal traffic for Indian shipping.**—Except for the establishment of the training ship ' Dufferin ', the Government failed to give effect to any of the other important recommendations of the Mercantile Marine Committee. Therefore, in the September session of 1928, Mr Haji moved his Bill in the Assembly for the reservation of coastal traffic. This made provision for seventy-five per cent of the stock to be vested in British Indian nationals. In the case of a joint-stock company, corporation or association, the chairman of the board of directors, and not less than seventy-five per cent of the number of members of the managing firm, and of the directors of the board, were to be British Indian subjects. The Bill further laid down that seventy-five per cent of the voting power was to be vested in British Indian subjects. It provided for a system of licences to be issued by the Governor-General-in-Council for engaging in the coasting trade of India. A five-year period was laid down in the Bill for the gradual reservation of the coastal traffic in this manner.

The principle of reservation of coastal traffic contained in the Bill has been adopted by practically all nations aspiring to develop their own mercantile marine. But the Government of India declared that they could not move in the matter until

the whole question of discriminatory legislation and the commercial relations between India and Great Britain, which was then before the Round Table Conference, had been decided. The Committee of the whole Round Table Conference included the following paragraph in the Report of the Minorities Sub-Committee (1931): 'At the instance of the British commercial community the principle was generally agreed to that there should be no discrimination between the rights of the British mercantile community, firms and companies, trading in India, and the rights of India-born subjects, and that an appropriate convention based on reciprocity should be entered into for the purpose of regulating these rights.'[1]

§43. **The Bill for the abolition of the deferred rebates system.**—Mr Haji also introduced in the Assembly (February 1929) a Bill for the abolition of the deferred rebates system in Indian coastal shipping, intended to be complementary to the Coastal Reservation Bill. While this Bill was designed to keep shipping earnings in India, the Deferred Rebates Abolition Bill aimed at ensuring a fair distribution of business among the Indian shipping companies once coastal trade was reserved. The abolition of deferred rebates would mean the end of monopolistic shipping combinations whether composed of non-Indian companies or Indian companies or both, and would inaugurate a new era, in which, so far as the coasting trade of India was concerned, an opening would be provided for new Indian companies by ending the existing shipping monopoly. Sir George Rainy, the Commerce Member, criticized the Bill on the ground that it did nothing to stop the rate war and that the deferred rebates system had been helpful in ensuring a regular service, stability of freights and equality between large and small shippers. He suggested that, as in the case of the Straits Settlements, an arrangement should be devised whereby the shippers would be free to leave the Conference once in three years without loss of rebate. The Commerce Member also urged that the Bill should wait at least till the House had decided one way or the other on the Coastal Reservation Bill.

Legislation of this type however could always be opposed as being contrary to the provisions regarding discrimination in the Government of India Act of 1935. Under these provisions it was not possible to discriminate against British steamship companies operating in coastal waters (see sections 113 and 115 of the Government of India Act, 1935).

§44. **Reconstruction Policy Sub-Committee on Shipping.**—The Reconstruction Policy Sub-Committee on Shipping appointed by the Government of India submitted its Report in April 1947. The Committee advocated a vigorous national policy of shipping and recommended the tonnage target of 2 million gross tons of shipping to be achieved by about 1954 with a view to securing for Indian shipping (i) the whole of the coastal trade; (ii) 75 per cent each of India's trade with Burma and Ceylon; (iii) 50 per cent of India's distant trade; and (iv) 30 per cent of the trade lost by the Axis powers in the East.[2]

The Committee proposed the establishment of a Shipping Board. The

[1] *Indian Round Table Conference Sub-Committee's Report*, p. 49.

[2] A delegation of representatives of Indian Shipping Companies which left for Britain in May 1947 to conduct negotiations with the British Government and British shipping interests for the expansion of Indian shipping returned in September 1947 without achieving any result.

Board was to be empowered to issue licences to companies plying in coastal waters and to control unfair competition and advise Government on the nature of State aid to be granted to Indian shipping and the nature of Government control to be applied to companies receiving such aid.

The majority Report defined the term 'Indian shipping' as 'shipping owned controlled and managed by the nationals of India'. Sir A. H. Ghuznavi, on the other hand, contended in his note of dissent that the term 'Indian shipping' should apply to companies in which at least 70 per cent of the shares are held by Indians. This was in accordance with the view that foreign participation in the economic development of India on a minority basis was not only harmless but positively beneficial in the present circumstances.

§45. **Recent attempts at regulation of coastal traffic.**—In September 1937 a non-official Coastal Traffic Bill, introduced in the Central Assembly by Sir A. H. Ghuznavi, was referred to the Select Committee.[1] As the mover pointed out, his Bill did not discriminate between British and Indian shipping. Its object was to regulate unfair competition in coastal waters in the shape of rate-cutting or the grant of rebates—a handicap which acts as a deterrent against Indian capital being invested in coastal shipping.[2] The Bill as redrafted by the Select Committee (1938) empowered the Central Government to deal with unfair competitive methods in coastal waters, after making inquiries, by fixing the minimum rates of fares and freight for the carriage of passengers and goods. Charging of rates lower than those fixed by the Central Government was made a penal offence. The Government of India were opposed to the Bill on the ground that it was unnecessary and impracticable. Its enactment might be followed by a shipping company mania. On the other hand, they were prepared to regulate coastal shipping within limits. It was first proposed to clear the ground by repealing the old Act of 1850, which threw the coastal waters of India open to the shipping of all nations, and then to take powers to regulate coastal shipping. This move was specially directed against the increased intrusion of Japanese and to a lesser extent of German shipping in the coastal trade of India.

In March 1939, the Council of State passed a resolution asking the Government to take more active steps for the expansion and protection of the Indian mercantile marine. Mr P. N. Sapru, the mover of the resolution, regretted that the Government had done nothing for Indian shipping when striking a fresh (1939) trade agreement with Great Britain.[3] Among the steps recommended by Mr Sapru were reservation of coastal trade for Indian shipping concerns, granting of subsidies, and the fixing of maximum and minimum rates of freight. Mr Dow, the Commerce Secretary, argued that it was no use for Government to fix

[1] A similar Bill moved by Mr P. N. Sapru in the Council of State was rejected by that body about the same time.

[2] For the views of the Indian Shipping Companies on this Bill see *Representation of the Indian Shipping Companies on Sir Abdul H. Ghuznavi's Bill.* They urged the incorporation in the Bill of a scheme of licensing tonnage plying on the Indian coast in order to encourage the healthy and steady development of Indian shipping.

[3] For further particulars regarding this aspect of the problem, see *Indian Shipping and the Proposed Indo-British Trade Agreement* (1939) published by the Indian National Steamship-Owners' Association.

rates, as it was difficult, indeed impossible, to enforce them and ensure that they were not altered in some way or the other. He regretted that there was no hope of Government granting any subsidy to the Indian shipping concerns, nor could Government reserve coastal traffic for them under the provisions of the 1935 Constitution Act.

§46. **Ship-building yard at Vizagapatam.**—World War II emphasized the importance of every maritime country building its own ships in its own yards. Thanks to the initiative taken by Mr Walchand Hirachand, an Indian ship-building yard has been established at Vizagapatam. The work of constructing ship-building berths was carried out by the Scindia Steam Navigation Co. Ltd. The work of building ships was held up for some time owing to the inability of the Government to provide the necessary machinery and steel. The first ship built by the company, S.S. *Jalausha*, was launched in January 1948. Altogether, including S.S. *Jalapankhi*, launched in December 1949, and S.S. *Jalapadma* launched in September 1950, five 8,000-tonners have been turned out in three years from the Vizagapatam shipyard. The last-mentioned ship is the first of three for which the Government of India placed orders in order to save the ship-yard from a threatened closure. In January 1949 the Scindia Company requested the Government of India to take over the yard.

§47. **Recent developments.**—After World War II, the Government of India appointed a Shipping Policy Committee which fixed a target of two million tons within five years. A number of new companies have been started and the strength of Indian shipping has now risen to 363,053 gross tons. In addition, three Pakistan shipping companies have 10 ships with a total tonnage of 34,809.

In November 1947, the Commerce Minister announced Government's intention to establish three shipping corporations in which Government would subscribe 51 per cent of the capital, nominate directors in proportion to their contribution and allow Indian companies to hold shares as well as run the corporations as Managing Agents. To avoid conflict of interests, the three corporations are to operate services on different routes.[1] To start with Government have decided to float only one corporation, for which two vessels have been purchased at a cost of Rs. 40 lakhs.

Air Transport

§48. **Civil aviation.**[2]—Since the war of 1914-18 civil aviation has made rapid progress, particularly in Western countries, and has initiated a far-reaching revolution in the transport system of the world.

Interest in civil aviation in India was aroused by the inauguration of a postal air mail service between Karachi and Bombay. The inauguration of the French and Dutch air services across India, the regular weekly service between England and Karachi, the introduction of the Empire Mail scheme and the general increase of civil aviation in all parts of the world, have stimulated both the Government and the public. India has become a party to the International Air Convention, and the Government of India have appointed a Director and Deputy-Director

[1] *The Indian and Pakistan Year Book*, 1949, pp. 409-10.

[2] For a brief account of the progress of civil aviation in India, see *The Indian and Pakistan Year Book*, 1949, pp. 275-81.

of Civil Aviation, and a Chief Inspector of Aircraft. Private enterprise has also come forward, and there are several Flying Clubs in India for imparting instruction in aviation. Apart from the assistance given to pilots for advanced training, the Government have instituted civil aviation scholarships. There are similar scholarships awarded by private bodies such as the Ratan and Dorabji Tata Trusts and the public airways companies. The Meteorological Department has also improved meteorological arrangements for aviation.

The establishment of daily air services on the main trunk air routes covering India north to south and east to west, with link routes connecting the trunk routes at suitable points and with extensions to the capitals of adjacent countries, was rapidly achieved with the development of civil aviation in India.

Stimulated by the establishment of the major air services, there is bound to be considerable independent development of the air services of secondary and local importance. In order to promote rational economic development, to ensure safety, regularity and reliability and to discourage the growth of mushroom organizations and prevent uneconomic competition, the Government have undertaken to regulate air transport services by a system of licences. An Air Transporting Licensing Board was constituted in July 1946. No scheduled air services could be operated after 1 October 1946 except under a licence granted by the Board. There are at present nine air services operated by Indian Air Transport companies. A new company for external air service was formed towards the end of 1947 under the name of Air-India International Ltd. in which Government hold 49 per cent of the share capital with an option to increase it to 51 per cent at any time. Any losses during the first five years are to be met by Government subject to repayment out of subsequent profits.

The aviation industry in India is at present suffering from an excess of operating units which is one of the reasons for their poor financial position. The fundamental difficulties of the industry are the poverty of the people, which reduces to insignificant proportions the potentialities of passenger traffic, and the slight industrial development which severely limits the air freight potential. The progress of aviation in India depends on Government control and subsidization.

The 1939-45 war greatly increased the urgency for developing aviation in India. The Indian Air Force was started on a small scale in 1932 after the first batch of Indian cadets had been trained at Cranwell. Schemes for expansion were put into force immediately after the outbreak of the war and the existing training facilities greatly enlarged.

§49. **Aircraft factory at Bangalore.**—The recent war thus greatly increased the importance of developing the production of aircraft in India itself. The credit for taking the initiative in this case also goes to Mr Walchand Hirachand. A joint-stock company, the Hindusthan Aircraft Company Ltd. with an authorized capital of Rs. 4 crores, was registered in December 1940 in Mysore State under the joint aegis of Mr Walchand Hirachand and the Mysore Government. The factory was set up at Bangalore under the direction of an American expert. The choice of Bangalore was largely prompted by the availability of cheap electrical power and high-grade steel from the Bhadravati Iron and Steel Works. The first Indian aeroplane came off the production line in July 1941, followed by a second one the next month. The Company's plans had advanced so much by February

1942 that it was hoped soon to be able to turn out 15 to 30 aeroplanes per month. However, at this juncture, the Government decided to operate the Company's factory as a Government concern, at least for the period of the war, owing to 'the financial risks and administrative complications involved in commercial operations'. The interests of Mr Walchand Hirachand were accordingly purchased by the Government of India in April 1942, and the Mysore Government, while retaining a financial interest, agreed temporarily to waive the right to a share in the active management. The operations of the factory were closely guarded during the war as a military secret. They were however limited to aircraft repair and maintenance.

In accordance with the recommendation of the United Kingdom Aircraft Mission which visited India in March 1946, the Government of India have decided to establish a national aircraft industry in India and aircraft production will initially be started in the Bangalore factory. A 20-year target of complete self-sufficiency in respect of the requirements of the Indian Air Force and of civil aviation in India is aimed at. A training centre has been established at Saharanpur for providing the necessary personnel for air services.

CHAPTER VI

THE TRADE OF INDIA

THIS chapter deals with the trade of India, and for the sake of convenient treatment, the subject may be divided into its main branches as follows:—(i) external trade consisting of (*a*) sea-borne trade, (*b*) entrepôt trade, (*c*) trans-frontier trade; and (ii) internal trade, including inland and coastal trade.

EXTERNAL TRADE

§1. **Historical retrospect.**—The early history of Indian trade may be dismissed briefly, our primary concern being with its development in the modern period since the middle of the last century. There is ample evidence of India's trade relations in ancient times with distant lands. As long ago as 3000 B.C., India had trading connexions with Babylon. Egyptian mummies belonging to 2000 B.C. are supposed to have been found wrapped in Indian muslin of the finest quality. 'There was a very large consumption of Indian manufactures in Rome. This is confirmed by the elder Pliny who complained that vast sums of money were annually absorbed by commerce in India. The muslins of Dacca were known to the Greeks under the name of *Gangetika*.'[1] Among other countries with whom India traded were China, Persia, and Arabia. The trade of India, as indeed all ancient trade, was in rare and costly commodities of comparatively great value in small bulk, in contrast with present-day trade characterized by the transport over large distances of cheap and bulky commodities catering for the needs of the masses. The principal articles of export were textile manufactures, metalware, ivory, perfumes, dye-stuffs, spices, etc., and the imports consisted of minerals, of which there was a deficiency in India, such as brass, tin, lead, and also wines, horses, etc. There was a net import of a large quantity of gold which suggests an excess of exports over imports—a feature which has all along characterized India's trade with other nations. There was also a certain amount of entrepôt trade chiefly in silks and porcelain previously imported from China, in pearls from Ceylon, and in precious stones from the Indian archipelago. This entrepôt trade may be taken as a token of India's possession of a fleet of merchantmen.

During the Muslim period, which may be said to have commenced from the eleventh century, certain new influences came to act upon the foreign trade of India. The early Muslim period being more unsettled than the preceding Hindu period must have adversely affected India's trade development. On the other hand, the communications established with India through the north-west frontier stimulated the overland trade. As Moreland points out, there were two regular routes on the frontier, from Lahore to Kabul, and from Multan to Kandahar. 'Kabul was a large commercial centre, and a meeting-place for merchants from India, Persia and countries to the north, while it lay on the route from India to the main caravan road between western China and Europe; Kandahar is the doorway from India to the greater part of Persia, and both routes carried a considerable volume of traffic when judged by standards appropriate to the conditions prevailing at the

[1] Malaviya's Minute of Dissent to the *Industrial Commission Report*, p. 295.

time.'[1] Moreover, the patronage of the Mogul courts imparted a considerable stimulus to Indian industries, particularly to those which produced luxury goods. The shipping trade was largely controlled by the Muslims, especially on the Malabar coast, and, to a lesser extent, in the Gulf of Cambay and the Coromandel coast, which later came largely into the hands of the Banias and Chettiars. Malabar was the great entrepôt for almost the whole trade of the Indian seas coming from the Far East and the Red Sea, Calicut being the principal port of this trade. During the Muslim period the general course of trade remained unchanged and 'Gibbons' mordant aphorism "that the objects of oriental traffic were splendid and trifling", is in substance as applicable to the sixteenth as to the second century '.[2] The imports were principally gold, for coinage and display; horses were imported in large numbers; and metals, such as copper, tin, zinc, lead and quicksilver; also luxuries like amber and precious stones. In payment for these imports India sent out her various textile fabrics, dye-stuffs like indigo, opium and other drugs, pepper and a few minor spices, etc.

Towards the end of the fifteenth century came the epoch-making changes in the trade routes owing to the discovery of an all-sea route to India via the Cape of Good Hope, which established the fateful contact between the East and the West. Till then the direct trade with Europe had passed on the Indian Ocean as far as Aden, was then unloaded in the Gulf of Suez and carried by land and water to the Mediterranean coast. It was thence taken up by the Italian traders of Venice and Genoa, who sent it farther west by sea, or to Antwerp by land over the Alps and then down the Rhine, at that period the chief distributor for western Europe. It was the prospect of annexing the large profits of this trade which largely inspired the Portuguese quest for a sea route to India. It was the linens and calicoes, the jewels and embroideries, woollen and silk manufactures, and not the raw materials, which attracted traders from western European countries like Portugal, Holland, England and France and supplied the basis for the lucrative trade of the East India Company, securing for it the virtual monopoly of trade with the East owing to the elimination of French competition after the Seven Years' War. There was at one time considerable opposition in England to the trade of the Company with India, since Indian imports of calicoes and spices, for which there was an insatiable demand in England, had to be paid for by an export of specie to India,[3] which was a poor market for the English woollens. Towards the end of the seventeenth century, the use of Indian textiles was penalized in England either by complete prohibition, or heavy import duties. We have already stated that the commercial instincts of the East India Company led it at first to encourage Indian industries, on which its export trade depended, but that the pressure of the vested interests in England led to a reversal of this policy in the eighteenth century, and India came to be looked upon primarily as a valuable source of raw materials necessary to develop the manufactures of England, which were rapidly expanding during the period of the Industrial Revolution.

[1] *India at the Death of Akbar*, p. 219. [2] ibid., p. 196.

[3] The acquisition of the Diwani of Bengal and the vicious system of investments (purchasing goods for export out of the Indian revenues) considerably reduced the export of bullion to India and lessened the opposition to the Indian trade.

The first half of the nineteenth century witnessed a remarkable change in the character of the trade between India and England. Henceforward, India began to receive those very commodities as imports which had hitherto bulked so largely in her export trade, namely, cotton manufactures and sugar. The Lancashire cotton industry had so developed that by the middle of the century imports of cotton piece-goods represented about half the total imports of foreign merchandise into India.

§2. India's trade from 1864-5 onwards.—The year 1869, when the Suez Canal was thrown open for navigation, marks the beginning of the modern period in the history of India's trade. The most striking characteristic of this period is the steady growth in the volume of the export and import trade.

Exports increased from an average annual value of Rs. 55·86 crores for five years from 1864-5 to 1868-9 to Rs. 353·31 crores, which was the quinquennial average for the period 1924-5 to 1928-9. During the same period imports rose in value from Rs. 31·7 to Rs. 251 crores.

The chief causes of this growth may now be briefly indicated. The establishment of peace and order with the practical completion of the British conquest of India by the middle of the last century supplied the much-needed security of life and property for the development of commerce. Improved means of transport and communication also opened up the country far and wide for trade. The most important single cause was the opening of the Suez Canal, which brought India nearer to England by about 3,000 miles. The canal rehabilitated the Mediterranean route to the East and gave new opportunities to countries facing the Mediterranean, such as France, Austria and Italy. The utility of this route was immensely improved by the laying of submarine cables between Bombay and Suez. This, together with the great improvement in naval architecture and the rapid growth of merchant shipping fostered by various countries, gave a great fillip to India's trade with distant lands. The greater part of India's exports came to consist of articles of considerable bulk and comparatively low value, which could now be transhipped cheaply over thousands of miles so as to satisfy the growing international demand for them. Foodstuffs like wheat, rice and tea, and raw materials such as cotton, jute, oil-seeds, hides and skins came to be exported in ever increasing quantities,[1] and they were paid for by the imports of manufactures, such as cotton piecegoods, machinery, hardware, railway materials, glassware, etc., from England, and later from other countries like Germany, the United States and Japan, where striking developments in manufacturing industry were taking place. The numerous internal customs barriers and transit duties which had so long impeded trade were swept away by 1853. The principle of free trade which had carried all before it in England about the middle of the last century was applied unhesitatingly to India. Almost all the export duties were abolished by 1874, and the discrimination in favour of British against foreign shipping was removed. Free trade however scored its greatest victory when, under pressure

[1] The agricultural policy of the Government in India was then largely inspired by the idea of stimulating the export of Indian agricultural produce, and the big irrigation schemes undertaken in the Punjab, the United Provinces and Sind were to a large extent in furtherance of this policy.

from Lancashire, all import duties with a few trifling exceptions were swept away in 1882.[1]

Though the Company's trade monopoly was abolished in 1813 and full freedom was given to all nationalities to establish commercial relations with India, and though all foreign countries were gradually placed on a footing of equality with England in respect of shipping, etc., Great Britain continued to be in practically monopolistic possession of the field until recently. The investment of British capital in Indian railways and other undertakings and the management of the railways by British companies, British control of shipping and banking, the establishment of trade organizations in the country, such as the British export houses and the European (British) Chambers of Commerce, and the power of directing the fiscal policy of the country, were the principal factors which gave Britain the upper hand.

§3. **The struggle for the Indian market.**—This supremacy gradually began to be undermined in the closing decade of the last century. Germany was the first power to challenge it and was later followed by Japan, whose interest in the trade with India was specially quickened after the Russo-Japanese War. The object of these powers was primarily to push the sale of their manufactures in India. But the organization created for this purpose also served to stimulate Indian exports of raw materials and foodstuffs, which these countries required for their own industries. The principal methods adopted for this purpose were: (i) the development of national shipping services, (ii) the establishment of branches of national banks, such as the German Deutsche Asiatische Bank and the Japanese Yokohama Specie Bank, which offered special credit facilities to their nationals, and (iii) the establishment of foreign commercial houses at the principal centres of trade, like Bombay and Calcutta. This activity had the full sympathy and support of the Governments concerned, and their consulates in India did yeoman service in fostering their countries' trade with India. The United States, however, was for a long time content to deal with India through London, and until after the outbreak of the 1914-18 war her efforts to promote direct trade relations were not so conscious and determined as those of Germany and Japan.

§4. **Summary of the position before the war of 1914-18.**—The combined effect of all the factors noticed above was seen in an enormous growth of the export and import trade of India, though the growth did not take place at a uniform pace throughout the period reviewed. Up to 1873, there was a heavy increase in exports, especially between 1864 and 1869 owing to the American Civil War, which led to large exports of cotton at high prices from India, while it checked the imports of piecegoods into the country owing to the difficulties of England in obtaining the usual supply of raw cotton. Between 1873 and the end of the century trade development was comparatively slow. The violent oscillations in the value of the rupee introduced an element of uncertainty and speculation in the foreign trade with gold standard countries and served to check its normal growth. Moreover, the famine of 1876-8 and the two others which occurred at the end of the century, and the repeated visitations of plague, which first appeared in Bombay in 1896, aggravated the situation. Lastly, while the successful stabilization of the rupee at

[1] It is true that the import duties had to be reimposed for revenue purposes in 1894 but they were maintained at the general low rate of five per cent *ad valorem*.

1*s.* 4*d.* between 1898 and 1914 smoothed the course of India's trade with gold standard countries, the appreciation of the rupee contributed, to some extent, as we have already seen, to the loss of trade in textiles with Japan and China.

The first fourteen years of the new century witnessed a remarkable expansion of the foreign trade of India, especially after 1905. The largest increase was revealed by the five years preceding the war of 1914-18. During these years the rupee was almost stable, public works such as railways and irrigation were being pushed forward with vigour, there were no serious famines such as those at the end of the previous century, and the virulence of plague was decreasing. Moreover, as already stated, Germany and Japan, and to a lesser extent the United States, were making organized efforts to push their trade, which was fast expanding under the stimulus of the economic transformation which they were undergoing, bringing them into line with England as industrial nations.

§5. **Effects of the war of 1914-18 on India's trade.**—The following tables[1] bring out the effects of the war of 1914-18 on India's trade:

TABLE I

Value (in millions of pounds) of the overseas trade in total merchandise

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127·5	96·5	92·1	106·8	109·6	125·7
Exports	166	121·4	133	167·9	163·3	170·2

TABLE II

Value (in millions of pounds) of the overseas trade (total merchandise calculated at the prices current in 1913-14)

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19
Imports	127·5	95·6	73·1	62·8	51·9	46·9
Exports	166	119	129·1	140·9	130·6	113·5

Table I above shows that both the branches of foreign trade received a setback on the outbreak of war in August 1914 and that, while the value of the exports recovered from 1916-17 onwards, that of imports lagged behind the pre-war year even so late as in 1918-19. Table II, which allows for the rise in war-time prices, shows that there was a far more serious reduction in the volume of trade especially of the import trade, which declined continuously throughout the war years. We may now briefly examine the causes which brought about this state of affairs. The war led to a complete cessation of trade with the enemy countries. At the same time the trade with the allied countries, like Great Britain, France, and Belgium, could not be maintained at the pre-war level owing to their preoccupation with the war. Trade with neutral countries was subjected to restrictions calculated to prevent munitions of war from India reaching Germany through such countries and

[1] See S. G. Panandikar, *The Economic Consequences of the War*, pp. 44-5.

to make Indian supplies solely available for the Allies. The sharp rise in freights due to the disappearance of enemy tonnage from the high seas and the pressure of war requirements on the remainder, largely discounted the advantage which India might otherwise have derived from the great demand in Europe for her commodities. The dislocation in the foreign exchanges and insecurity on the sea were also factors which disturbed the course of trade. The country, however, soon began to adapt itself to war conditions. Large quantities of sandbags for trench warfare and hides for the manufacture of boots for the soldiers were required, and this greatly stimulated exports. Though the import trade did not experience the same revival, the gap caused in the Indian market was partly filled up by increased imports from the United States and Japan, which fully exploited the situation so created to their own advantage. Thus the war affected Indian trade more adversely than the trade of some other countries like Japan.

A feature of India's foreign trade during the war of 1914-18 was the increase in the exports of manufactures, whose percentage to the total export trade rose from 22·4 per cent in 1913-14 to 36·6 per cent in 1918-19. The artificial stimulus given by the war to Indian industries like cotton, jute, leather, steel and iron has already been noticed, and this accounts for the increase in the exports of manufactures.

§6. **Inter-war trade from 1919-20 to 1939-40.**—The early inter-war period was characterized by a trade boom caused by the removal of many of the war-time prohibitions on exports, as well as a gradual resumption of commercial intercourse with enemy countries accompanied by an improvement in the freight position. There was also a brisk demand for Indian produce on the part of the Western countries for the reorganization of their industries. The revival of trade, especially on the side of exports, would have been even more striking but for the railway congestion in India, high prices, labour troubles, unstable foreign exchanges, the rise in the exchange value of the rupee and the continuation of the restrictions on the export of cereals owing to the failure of the monsoon in 1918-19. Even as it was, however, the pace of the post-war boom was too fast and it was inevitable that before long it would be succeeded by a slump, indications of which were clearly apparent in the latter part of the year 1920-1. The export trade was the first to be affected. The markets of Great Britain, the United States and Japan, who were all among India's best customers, were glutted with Indian produce, and there was a considerable slackening of the demand on their part. The countries of central Europe, which had been a valuable market for Indian exports during the period before 1914, no doubt badly wanted Indian products, but could not buy them owing to their shattered resources and reduced purchasing power. The unsatisfactory rains of 1920 in India and the high prices of foodstuffs necessitated the continuance of the embargo on the export of foodstuffs. There was also a severe crisis in Japan which checked the exports of Indian cotton to that country. The ill-fated attempts of the Government to stabilize the exchange value of the rupee at 2*s.* (gold),[1] further paralysed the already weak export trade. The import trade, on the other hand, expanded rapidly. India's import requirements had been starved during the war and orders had been placed for machinery and other manufactured goods during the war and after the armistice for delivery at the discretion

[1] See ch. viii.

of the manufacturers, and these now began to pour into the country. The high exchange also gave a powerful stimulus to the import trade and orders were placed for immense quantities of foreign manufactured goods. It is no matter for surprise, therefore, that there was a heavy balance of trade against India, to the extent of Rs. 79·80 crores in 1920-1, which continued into the next year when it amounted to Rs. 33·94 crores.

After the year 1922-3 a recovery was discernible. And at least so far as the import trade was concerned, the trend towards the restoration of normal conditions was continuously in evidence till the year 1929-30. The conditions which favoured the progress towards gradual recovery were the progressive stabilization of the European currencies, the improvement in the credit position of the Central European countries, and the settlement of the reparations question by means of the Dawes Scheme in 1924.

§7. **India's trade during the world economic depression.**—A downward trend of trade started in October 1929, after the Wall Street collapse, and afterwards spread to most other countries all over the world. The main causes of this trade depression, which dominated India's foreign trade during the years 1929-30 to 1933-4, may be summed up as follows:—(i) overproduction of both raw materials and manufactured products, but particularly of the former; (ii) monetary causes, especially the concentration of gold in America and France resulting in a depletion of the reserves of the Central Banks in other countries and the consequent deflationary policy followed by these banks until the suspension of the gold standard in September 1931 by Great Britain, followed by a large number of other countries; (iii) political unrest, notably in India, China and South America and subsequently in other countries and restrictions on trade by way of tariffs, quotas, exchange control, etc., during the era of exchange instability ushered in by the widespread abandonment of the gold standard. The fall in the value of India's exports was mainly due to the disastrous fall in the prices of agricultural raw materials[1] and the decline in the foreign demand for India's staple exports. The fall in the value of imports was largely the result of the reduced purchasing power of consumers in India, the tense political situation in the country and the extension of home production of cotton textiles and sugar stimulated by the policy of discriminate protection since 1924.

The fall in the case of exports was naturally far greater than in the case of imports owing to the fact that the prices of agricultural commodities and raw materials, which form the bulk of India's exports, fell to a much greater extent than the prices of manufactured goods which form the bulk of Indian imports. Had it not been for the enormous quantity of gold exported from India after Great Britain went off the gold standard, the balance of trade in favour of India would have dwindled to a negligible figure indeed. The slump in the export trade was at its worst in 1932-3, when the value of the exports dropped to Rs. 136 crores, and the visible balance of trade in merchandise was only about Rs. 3 crores, the smallest figure on record. The worst phase of the world depression came to an end in 1932, and the early months of 1933 saw a considerable revival of business activity in several countries under the stimulus of devaluation and cheap money

[1] See ch. x.

conditions. At the same time the prevalent urge towards economic nationalism under the influence of which each country was trying to reserve its markets for its own nationals, and the failure of the World Economic and Monetary Conference, held in London (1933), owing to the hostile attitude of the United States of America towards the stabilization of world currencies, handicapped recovery of world trade.

The great American experiment of socialization of finance and industry, undertaken in the Recovery Plan of President Roosevelt, while it exercised a certain beneficial influence on world prices, obscured the beginning of a genuine rise in the world prices of commodities by the greater speculative rise based on the prospect of inflation in America. The period of dollar uncertainty probably enhanced the difficulties in the path of increased international trade.

§8. **World economic recovery and India's trade.**—In 1933-4 Indian conditions generally showed some progress towards recovery so far as the export trade and the visible balance of trade were concerned, although agricultural conditions remained much the same. The years 1934-5, 1935-6 and 1936-7 were marked by further progress in economic recovery. In the earlier stages, the improvement was confined to particular countries or industries, but in 1936 the world appeared to have definitely emerged from the paralysing conditions of the great depression. The gradual depletion of stocks of primary commodities since 1934, the restriction schemes for regulation of production of various commodities adopted on a voluntary basis by some of the chief producers, the collapse of the gold bloc under the leadership of France, and the devaluation of the erstwhile gold currencies in September 1936, brought about a rise in the prices of many commodities. The rise became striking during the first half of 1937, owing to the influence of an additional factor, namely the heavy government expenditure on armaments in many countries, which gave a great stimulus to the heavy industries, and had an exhilarating effect on the general economic situation. Conditions of international trade were, however, no freer than at the bottom of the depression when such devices as high import tariffs, quotas, clearing agreements, and other measures regulating trade were adopted, notably by Germany and Italy. In fact, the increasing tendency towards bilateralism was a marked feature of world trade during the years just before World War II.

India followed the general world trend towards recovery, although owing to her special conditions her course of recovery was somewhat different from that of other countries. The depression which started in 1929 hit agricultural countries like India with special severity, owing to the unprecedented fall in the prices of primary produce. The improvement in agricultural prices began somewhat earlier, but it was only during 1936-7 that there was an appreciable advance in the prices of India's agricultural products. (See also ch. xi.) This marked improvement was chiefly the result of a general recovery in the demand for primary commodities and raw materials. India's trade, especially her export trade, in consequence made a considerable recovery, especially in 1936-7 when it recorded an advance of nearly Rs. 36 crores over the previous year's total. In the same year the trade balance in private merchandise in favour of India, which had sunk to only Rs. 3 crores in 1932-3, mounted to Rs. 78 crores.

§9. **India's trade during the 'recession' period (1937-8 to 1938-9).**—With the business 'recession' which started in the United States about April 1937 and which gathered momentum as the year wore on, the economic recovery of the world received an unexpected setback. The sudden reversal of the upward trend in business conditions was caused by the inevitable bursting of the bubble of speculation as also by the nervousness regarding future shortage of raw materials and other factors, resulting in the gold scare in the United States, the restrictions placed on credit facilities by banks, and relaxation of restriction schemes. World prices for primary commodities fell sharply and remained low till the middle of June 1938.

However, in the early part of 1939 business activity had risen moderately. This is explained partly by the adoption of policies of monetary expansion and of increased public expenditure all over the world, especially in the United States, and partly by the high expenditure on armaments.

The economic 'recession' and the reversal of the commodity boom in the world markets in 1937 did not fail to affect adversely prices and agricultural conditions in India. The prices of most Indian staple products declined sharply, involving shrinkage in the income of the agriculturist (see also ch. xi). The downward trend in India was accentuated by the Sino-Japanese conflict which seriously curtailed the trading capacity of Japan, India's principal customer for cotton. The overseas trade of India in 1937-8 compared with the previous year showed an increase in imports accompanied by a decrease in exports with the result that the net exports of private merchandise from India (excluding Burma) declined from Rs. 51 crores in 1936-7 to Rs. 17·56 crores. The total value of India's foreign trade in private merchandise declined from Rs. 363 crores in 1936-7 to Rs. 322 crores in 1938-9. The fall of as much as Rs. 41 crores in exports was in part the result of the depressed condition of the primary markets of the world and in part of the reduced purchase of Indian cotton by Japan. The fall in imports was caused by the smaller purchasing power in the hands of the agriculturist. The larger decrease in imports in 1938-9 improved the trade balance by a couple of crores as compared with the previous year.

§10. **India's foreign trade during the war (1939-45).**—With the outbreak of war in September 1939 and its subsequent extension in scope and increase in intensity, a number of factors affecting the volume and value of India's foreign trade were brought into play.[1] At first, most of these factors were unfavourable but a number of favourable factors appeared later. The net result has not shown any consistent deterioration and has in some respects even recorded improvement.

The unfavourable factors arose mainly out of political uncertainty which preceded the declaration of war. There was, for example, a natural hesitation in India to place orders with European countries in the first year of the war for fear that before the orders could be executed, hostilities might extend to them. Actually the conflagration spread with overwhelming rapidity and India lost a number of her important markets and sources of supply.

Germany, Czechoslovakia and Poland were excluded in the first week of September 1939. In the spring of 1940, Norway, Holland, Denmark, Belgium,

[1] The treatment of developments relating to foreign trade during World War II owes much to a note prepared by Professor N. S. Pardasani and kindly placed at our disposal.

France and Italy were enemy-occupied territories. The next year saw the extension of this area to the south-east of Europe. The trade with Russia had ceased earlier but was resumed after the German attack on that country in June 1941. The freezing of Japanese assets in India in July 1941 gave a blow to Indo-Japanese trade relations and, in December 1941, Japan became an enemy country. The rapid succession of conquests by Japan closed one important market after another for India in Indo-China, Thailand, the East Indies, Malaya and Burma. The Japanese occupation of Burma took away not only one of our best customers and suppliers but also closed the Burma road to China and thereby affected Indo-Chinese trade. Taking all these countries with which India could no longer trade, it would be no exaggeration to say, on the strength of pre-war figures, that about half of India's foreign trade was cut off. This applied to both exports and imports.

To this must be added the inevitable shrinkage caused by the inaccessibility of certain neutral countries like Sweden and Switzerland with whom trade, though not officially stopped, was drastically reduced owing to their proximity to enemy areas. Communications were unsafe and the danger of re-exports to the enemy great. Thus the only important countries with which India found it possible to trade were the United Kingdom, the United States, Canada, Australia and other parts of the British Empire and the Near and Middle East countries in Asia and Africa. Even here one important handicap was the increasing difficulty of providing shipping facilities. The German U-boat menace at the beginning of the war sent up freight rates and the cost of insurance of goods. The worsening of British political relations with Italy in 1940 diverted the Indo-European trade to the Cape route and thus painfully emphasized the shortage of shipping space. The Japanese entry into the war in December 1941 made the Pacific routes unsafe and thus affected India's trade with the United States, Australia and New Zealand.

To the above factors we must now add another. After the war started, almost every country with which India had trading relations introduced a complicated network of trade restrictions. India on her part pursued a similar policy. Soon after the declaration of war, the Central Government imposed restrictions on the export trade in a large variety of articles. Trading with enemy countries was prohibited. Steps were also taken to see that supplies did not reach the enemy by indirect channels and to conserve supplies of all essential articles for the requirements of India and the allied countries. With this object in view an elaborate system of export restrictions and licences was introduced.[1] Export licences were issued for some articles by the Department of Supply and for others by the Export Trade Controller. Restrictions were also imposed on imports of as many as 68 items in May 1940 with a view to conserving foreign exchange and lessening the pressure on the limited shipping available. Most of these were luxury goods, including commodities of everyday use, and the restrictions incidentally stimulated many small and struggling industries to manufacture substitute or alternative goods. All this meant considerable dislocation of our normal channels of trade.[2]

If the adverse factors noted above had alone been in operation, the results would have been disastrous. The preoccupation of the United Kingdom and

[1] For further particulars see *Review of the Trade of India* (1939-40), Appendix.

[2] For some details regarding the nature and machinery of war-time controls in India, see L. C. Jain, *Indian Economy during the War*, pp. 62-7.

other allied countries with production of war-material and the drain on their man-power; however, increased their demand from India for several raw materials, foodstuffs and manufactured articles. Further, their inability to produce for export markets and the withdrawal of European supplies from Asiatic and African countries created a low pressure area in the Near and Middle East with a consequent further increase in the demand for Indian goods. The shortage of shipping space intensified the tendency to rely on nearer markets. This factor also affected the trade of the United Kingdom and American countries with the countries on the borders of the Indian Ocean. India stepped into the breach and succeeded in capturing a good portion of this export trade. Besides war conditions, movements of trade have in recent years been governed by the Government's policy of encouraging larger supplies of *essential* raw materials, machinery and consumers' goods[1] and discouraging imports not considered to be essential for the national economy and of restricting or prohibiting exports regarded as vitally necessary for internal use.

The following figures of India's foreign trade are subject to the following observations:

(i) Trade on defence account involving financial payments as between Governments is excluded. But lend-lease imports and reciprocal lend-lease exports on non-defence account not resulting in money transfers are included. Government refrained from publishing full and recent statistics in order to prevent useful information reaching the enemy.

(ii) The figures must be read in the light of the considerable changes of price levels in recent years. A rise in the value of foreign trade often concealed a decline in the quantum of trade.

VALUE OF INDIA'S SEA-BORNE TRADE[2]

(in crores of rupees)

Year	Imports	Exports (including re-exports)	Total	Balance of trade
1938-9	169	152	321	+17
1943-4	210	119	329	+91
1944-5	228	201	429	+27

The abnormal conditions during the war years inevitably subjected foreign trade to large dislocations and vicissitudes. The stimulation of exports in 1939-40, the first year of the war, was mainly due to large purchases made by the allies in the Indian market. In 1940-1, which was the first full year of the war, there was a considerable shrinkage of exports largely owing to the loss of our European markets caused by German occupation of France, Belgium and Holland and by acute shipping scarcity. In 1941-2, exports recovered in value, owing to easier transport conditions and heavier demand from the Commonwealth and allied countries, especially the U.S.A. and the Middle East. The

[1] The Open General Licence was instituted in March 1945 for the importation of several classes of consumers' goods and essential raw materials.

[2] *The Indian Year Book*, 1947, pp. 843-4.

decline in trade during 1942-3 was mainly explained by the loss of Burma and the virtual closing of the Pacific, and so on.

§11. **Gregory-Meek Mission.**[1]—A notable step taken by the Government of India to revive the export trade was the deputation in July 1940 of Dr. T. E. Gregory and Sir David Meek to visit the United States of America on a trade mission. In their Report, which was published in January 1941, the authors frankly admit that it is not possible for India to find in the United States an effective substitute market for the entirety of the lost European markets.[2] Most of our former large exports to Europe, notably jute, groundnuts, cotton, oilcakes, wheat, raw hides and skins, cannot be shipped in bulk to the United States. America has surplus cotton of her own, grows wheat and groundnuts, increasingly substitutes cotton and paper goods for jute, manufactures her own oilcakes, and tans most of her own hides and skins. Another factor is the growth of inter-American trade promoted at the Havana Pan-American Conference to offset Axis ambitions in South America. Many South American raw materials—such as Argentine linseed, groundnuts, oilcakes, and seeds—compete directly with India's.

The American consumer-market for finished and semi-finished goods has possibilities. But it is a fickle and strenuous market and calls for vigilance, initiative, personal contacts, and publicity campaigns on the part of Indian manufacturers. Publicity must be encouraged even to retain the existing markets, particularly for jute, which has to reckon with increasing competition of substitutes.

§12. **Export Advisory Council and other measures.**—The Gregory-Meek Report makes it abundantly clear that India must explore non-American markets to compensate for the loss of the Continental markets. We must for instance seek to expand Indo-British trade as far as possible and also stimulate our exports to non-Commonwealth countries like China, Arabia, and Africa. To some extent the loss of markets made inaccessible by the war was made up by inter-Commonwealth trade (see §18 below) and, to a smaller extent, by trade with a few non-Commonwealth countries, e.g. increased exports of cotton piece-goods to Africa, Arabia, etc. In this connexion mention must be made of the Export Advisory Council set up in May 1940, with the Commerce Member as Chairman, and twenty-one other members representing different trades and industries. Its functions were: (i) to take up the discussion of the present export difficulties; (ii) to make suggestions relating to the expansion of the exports of staples and discovery of alternative markets; (iii) to promote the expansion of Indian manufactures; and lastly, (iv) to discuss facilities which can be afforded to unofficial trade delegations from India to countries overseas.

§13. **Characteristics of India's sea-borne trade.**—Table I (p. 172) and Table II (p. 173) show the comparative importance of the principal articles imported into and exported from 'British' India respectively. They also serve to illustrate numerically the oft-repeated statement that the bulk of the exports from India consist of food-stuffs and raw materials and the bulk of the imports of manufactured articles. We have already explained how this characteristic of India's present-day trade stands in marked contrast with her foreign trade up to the opening decades of the last century, and also the process of the transition from the one to the

[1] §§11-12 should be read with §§ 36-7.

[2] *Report*, par. 67.

other. We have also discussed the question relating to the policy to be followed with regard to the export of food-stuffs and raw materials from the country.[1] Similarly, in the preceding chapters hardly a single opportunity has been lost of insisting on the desirability of rapid industrial development in the country so as greatly to reduce our present dependence on foreign manufactures.

TABLE I—IMPORTS

(In thousands of rupees)

	1942-3	1943-4	1944-5	Percentage on total imports in 1944-5
Oils	27,76,25	36,48,02	80,70,33	40·14
Cotton and cotton goods ..	16,78,52	18,86,21	25,55,05	12·70
Machinery of all kinds ..	10,51,78	11,30,86	16,20,08	8·10
Dyes and colours	5,43,18	8,29,61	7,92,30	3·93
Chemicals	4,67,29	4,97,20	6,88,23	3·42
Wool, raw and manufactured ..	3,78,20	4,46,98	3,14,73	1·56
Metals and metallic ores ..	6,18,87	4,23,01	6,52,99	3·24
Instruments, apparatus and appliances	3,35,16	3,01,08	4,38,57	2·18
Drugs and medicines ..	1,46,95	2,08,73	2,87,24	1·42
Paper, pasteboard and stationery ..	2,15,59	1,96,33	2,90,82	1·44
Tobacco	1,33,19	1,59,71	2,90,28	1·44
Precious stones and pearls, unset ..	55,73	1,43,82	2,48,92	1·22
Grain, pulses, and flour ..	30,85	30,72	8,09,18	4·01
Salt	88,72	1,54,13	2,41,48	1·20
Liquors	1,18,92	1,24,09	1,08,33	0·52
Vehicles	5,71,18	1,26,98	1,77,86	0·88
Spices	1,51,72	89,60	1,53,84	0·76
Hardware..	1,00,55	93,67	1,29,24	0·64
Fruits and vegetables ..	1,11,56	87,02	1,55,03	0·77
Tea chests	70,19	82,52	1,90,41	0·94
Provisions and oilman's stores ..	70,86	55,43	1,20,65	0·60
Hides and skins, raw and tanned ..	53,89	62,17	41,66	0·20
Arms, ammunition and military stores	37,61	33,83	32,60	0·16
Tallow, stearin and wax ..	36,48	39,52	22,88	0·11
Gums, resins and lac	27,48	19,80	48,93	0·24
Glass and glassware	25,64	15,77	41,32	0·20
Artificial silk	18,59	5,85	36,08	0·18
Wood and timber	16,15	11,76	2,31	..
Earthenware and porcelain ..	10,73	6,39	18,46	0·09
Silk, raw and manufactured ..	2,98	45	9	..
Rubber, raw and manufactured ..	26,23	10,46	14,65	0·07
Haberdashery and millinery ..	11	14	17	..
Apparel	10,24	4,62	14	..
Sugar	1,87	13	2	..
Toys and requisites for games ..	16	12	75	..
Soap	..	6	14	..
Paper-making materials ..	2,75	4,33	34,08	0·17
Umbrellas and fittings ..	..	..	..	..
Animals, living	3,70	38	30	..
Fish	1,90	1,74	3,34	..
Jute and jute goods	3,39	5,73	1,85	..
Coal	1,08	29	3	..
Other articles	10,38,83	83,867	14,53,14	7·23
Total value of imports ..	110,35,07	117,77,93	200,98,06	..

[1] See vol. I, ch. vi.

Even long before the war of 1914-18, a slight improvement in this direction had taken place and the percentage of exports of manufactures to the total exports had shown a tendency to increase gradually, though the bulk of the exports, then as now, were in the form of raw materials and food-stuffs. During the period covered

TABLE II—EXPORTS

(In thousands of rupees)

	1942-3	1943-4	1944-5	Percentage of total exports in 1944-5
Jute, raw and waste ..	9,01,57	8,32,91	7,50,02	3·52
Jute manufactures ..	36,40,93	49,47,19	60,42,42	28·62
Cotton, raw and waste ..	5,30,56	7,48,79	7,70,17	3·61
Cotton manufactures ..	46,19,10	42,62,42	37,60,20	17·81
Tea	31,90,13	37,18,82	38,11,69	18·50
Seeds	10,51,76	11,14,92	10,53,35	4·99
Leather	4,76,05	4,38,40	4,21,22	1·99
Metals and ores	3,92,67	3,49,75	2,52,39	1·18
Non-metallic ores	2,80,17	2,91,07	3,03,92	1·43
Grain, pulses and flour ..	6,93,23	2,30,82	1,23,22	0·57
Hides and skins, raw ..	3,38,36	4,12,84	3,98,54	1·87
Tobacco	1,49,20	76,45	1,40,01	0·70
Fruits and vegetables ..	1,97,06	2,27,55	4,59,14	2·12
Oil cakes	61,49	14,92	41	..
Coal	35,54	21,08	22,78	0·10
Wool, raw and manufactured ..	1,61,12	2,34,98	3,90,68	1·84
Gums, resins and lac ..	3,23,65	2,74,83	4,74,70	2·22
Oils	1,36,84	83,13	1,05,57	0·50
Coir manufactures ..	86,28	97,16	1,93,41	0·90
Spices	1,94,11	1,44,81	1,11,45	0·52
Rubber, raw and manufactured	37,13	51,89	1,13,54	0·53
Hemp, raw	52,37	67,30	69,79	0·31
Coffee	52,38	69,95	24,52	0·12
Provisions and oilman's stores..	59,92	58,49	24,69	0·12
Fish	72,29	1,55,38	2,25,79	1·06
Chemicals, drugs and medicines	58,52	66,33	40,66	0·17
Dyes and colours	36,05	34,17	50,13	0·23
Paraffin wax	21,31	1,22,47	1,22,90	0·57
Wood and timber	13,81	9,67	13,43	0·06
Apparel	55,02	40,98	52,77	0·22
Sugar	1,07,96	42,27	31,72	0·15
Silk, raw and manufactured ..	2,49,24	9	6	..
Fodder, bran and pollard ..	7,15	7,06	3,12	..
Cutlery, hardware, etc. ..	26,73	22,55	26,23	0·12
Animals, living	15,49	23,92	28,44	0·12
Tallow, stearin and wax ..	7,62	2,92	1,70	..
Furniture, etc.	1,70	2,45	4,35	..
Glass and glassware ..	7,33	7,60	11,72	0·05
Paper, pasteboard and stationery	5,47	5,31	30,08	0·14
Other articles	5,94,63	6,11,55	6,43,62	3·04
Total value of exports ..	189,41,94	199,25,09	210,04,55	100·00

by the war of 1914-18, this percentage showed an appreciable increase, which however was not fully maintained in the post-war years. The 1939-45 war, by accelerating the industrialization of the country, strengthened the tendency for the percentage of exports of manufactures to total exports to increase.

Another characteristic of India's foreign trade is that while the imports consist of a wide range of articles, the export trade is restricted to a comparatively few great staples like raw cotton, jute, oil-seeds and food grains.

The third noteworthy feature is that Great Britain holds a predominant position in our foreign trade, especially on the import side see (§§15-19 below). On the export side, while she is the most important single customer, the aggregate of that trade is more evenly divided between a number of countries. Lastly India's foreign trade normally shows an excess of exports over imports, i.e. a favourable balance of trade. (See §24 below.)

§14. **Recent changes in composition of trade.**—The following table gives the composition of India's imports and exports (including re-exports) during 1944-5 and 1945-6 and compares them with the pre-war year 1938-9. (The figures are however exclusive of trade on Government account.)[1]

	1938-9		1944-5		1945-6	
	Rs. crores	per cent	Rs. crores	per cent	Rs. crores	per cent
Imports						
Food	24,00	15·7	18,85	9·4	22,25	9·3
Raw materials	38,18	21·7	117,26	58·3	116,57	48·5
Manufactured articles ..	92,79	60·8	62,47	31·8	97,53	40·6
Exports						
Food	39,43	23·3	49,83	20·9	58,44	22·5
Raw materials	76,28	45·1	58,19	25·6	84,85	26·5
Manufactured articles ..	50,72	30·0	116,27	51·5	114,68	46·0

The import figures show a substantial decrease in the percentage of manufactured articles from 60·8 in 1938-9 to 31·8 in 1944-5 with an increase to 40·6 in 1945-6. Imports of raw materials, on the other hand, increased from 21·7 per cent to 48·5 per cent in 1945-6 to supply the needs of growing industrial activity in the country. The fluctuations in the imports of food-stuffs reflect the world shortages rather than the demand for them which has been keen and intensely urgent throughout the period in question and has been limited only by the impossibility of securing larger imports. Before the 1939-45 war, raw materials headed the list of exports. Now their place is taken by finished articles. This was mainly because the markets in the Middle East came to depend largely on India for the supply of manufactured goods, especially textiles, as the war-ravaged countries of Europe were unable to export goods to these markets on anything like the pre-war scale. In order that these gains should be permanent we must pursue a suitable policy of protection with foresight and vigour. To retain the advantage we have obtained in foreign markets by the temporary elimination of rivals our industries will have to make rapid strides in efficiency and salesmanship. Further, we must not allow ourselves to be unduly buoyed up by our present progress in industrialization. We must remember that our foundations will remain insecure so long as we remain without a satisfactory development of heavy industries.

The reduction during the war in the exports of raw materials was not due so much to their increased use in the country itself for the growing industries as to the inevitable closing of our most important foreign markets and this has caused much distress among our agriculturists.

[1] *Indian and Pakistan Year Book*, 1948, pp. 335-6.

TABLE III—PERCENTAGE SHARE OF THE PRINCIPAL COUNTRIES IN INDIA'S TOTAL FOREIGN TRADE IN MERCHANDISE ONLY

Countries	Pre-war average[1]			War average[1]			Post-war average[1]			1938-9			1939-40		
	Imports	Exports including re-exports	Total	Imports	Exports including re-exports	Total	Imports	Exports including re-exports	Total	Imports	Exports including re-exports	Total	Imports	Exports including re-exports	Total
BRITISH EMPIRE—															
United Kingdom ..	62·8	25·1	40·0	56·5	31·1	41·2	57·6	24·2	39·5	30·5	34·3	32·5	25·2	35·1	30·8
Burma	..	..	..	..	..	..	..	..	..	16·0	6·6	11·0	19·0	6·3	11·8
Ceylon	0·5	3·7	2·4	1·1	4·3	3·0	0·7	4·8	2·5	0·8	3·2	2·0	0·9	3·1	2·2
Straits Settlements ..	2·1	3·4	2·9	3·0	2·7	2·8	1·9	2·7	2·3	2·7	1·3	2·0	2·9	1·3	2·0
Australia	0·7	1·4	1·1	0·8	2·2	1·7	1·3	1·7	1·5	1·6	1·8	1·7	1·4	2·6	2·1
Hong Kong ..	0·7	4·1	2·7	0·9	2·0	1·6	0·7	2·3	1·6	0·2	0·5	0·4	0·4	0·5	0·4
Mauritius and dependencies	1·8	0·6	1·1	1·1	0·6	0·8	2·2	3·1	2·7	..	0·5	0·3	..	0·4	0·2
Total (including other British possessions) ..	69·7	41·1	52·3	65·4	51·7	57·1	65·2	41·4	52·3	58·1	53·6	55·7	56·3	55·9	56·1
FOREIGN COUNTRIES—															
Japan	2·5	7·5	5·5	10·4	11·2	10·9	6·9	13·3	10·4	10·1	8·8	9·4	11·7	6·6	8·8
United States of America	3·1	7·5	5·8	7·0	11·9	9·9	8·5	12·0	10·4	6·4	8·4	7·5	9·0	12·7	11·1
Java	6·4	1·3	3·3	7·8	1·1	3·8	6·8	1·0	3·7	0·3	0·4	0·4	2·0	0·7	1·3
France	1·5	6·6	4·6	1·3	4·5	3·2	0·9	4·8	3·0	0·9	3·7	2·4	0·9	3·7	2·5
Italy	1·0	3·2	2·3	1·2	3·9	2·8	1·0	3·2	2·2	1·8	1·5	1·7	1·2	1·0	1·1
China (excluding Hong Kong and Macao) ..	1·1	3·9	2·8	1·3	2·0	1·7	1·2	3·6	2·5	1·1	1·5	1·3	1·6	4·0	2·9
Iran	0·4	0·5	0·5	0·6	1·6	1·2	0·7	1·3	1·0	2·3	0·5	1·3	1·9	0·4	1·1
Union of Socialist Soviet Republics ..	0·1	0·9	0·6	0·1	1·2	0·8	0·1	..	0·1	0·1	0·2	0·2	0·1	..	..
Netherlands ..	0·9	1·5	1·3	0·6	0·2	0·3	0·9	1·5	0·9	0·9	2·2	1·6	0·9	1·2	1·1
Belgium	1·9	5·3	3·9	0·3	0·5	0·4	1·8	3·7	2·9	1·9	2·5	2·2	1·5	1·5	1·5
Germany	6·4	9·8	8·5	0·7	0·9	0·8	2·8	4·9	4·0	8·5	5·0	6·6	4·0	1·4	2·5
Austria[2]	2·2	3·5	2·9	0·2	0·4	0·3	0·2	0·2	0·2	0·3	..	0·2	0·1	..	..
TOTAL (including other foreign countries) ..	30·3	58·9	47·7	34·6	48·3	42·9	34·8	58·6	47·7	41·9	46·4	44·3	43·7	44·1	43·9

Note.—As a result of the separation of Burma the trade statistics from 1937–8 given in this table include the trade of British India with Burma and exclude the direct trade of Burma with foreign countries.

[1] 'Pre-war average' means the average of the five years 1909-10 to 1913-14, 'war average' the average of the five years 1914-15 to 1918-19, and 'post-war average' the average of the five years 1919-20 to 1923-4.

[2] Figures prior to 1921-2 represent Austria-Hungary.

The total picture of development in our trade which thus emerges is one of sober optimism, or even of gloom, only moderately relieved by a certain halting and artificial advance in industrialization.

§15. **The direction of India's trade.**—The table on p. 175 shows the percentage shares of foreign countries in India's total trade and serves to bring out the effect of the separation of Burma on the distribution of India's overseas trade.

These figures show that on the import side the United Kingdom, and Europe generally, dominated the situation, especially before the war of 1914-18; while a feature of the distribution of the export trade has always been the large number of countries participating in it, though the United Kingdom is still the biggest single customer for Indian exports. The causes of the predominance of the United Kingdom in India's trade have already been indicated, as also the successful attempts made by Germany and Japan to establish direct trade relations with India in the period before the war of 1914-18 and by the United States during and since that war. We may now discuss the principal tendencies regarding the direction of India's trade, as revealed by these figures, before, during and after the war of 1914-18.

§16. **Distribution of India's trade before 1914.**—During the period before the war of 1914-18, there was a tendency for both the import and export trade to be diverted from the United Kingdom to other countries. As regards the distribution of imports, the United Kingdom supplied at the close of the last century as much as 69 per cent of the Indian imports. The share of Germany was only 2·4 per cent and that of the United States 1·7 per cent, Japan being nowhere with her 0·6 per cent. By 1913-14 we notice that a remarkable change had taken place. While the share of the United Kingdom had come down to 64·1 per cent, the German share had increased to 6·9 per cent and those of Japan and the United States to 2·6 per cent each. Thus Germany occupied the second place next to the United Kingdom in 1913-14. The increase in the trade with Germany was attributed partly to the special technical skill which she had developed in certain lines, partly to the displacement of the expensive British goods by cheaper substitutes more readily absorbed by the Indian bazaars, and partly to the careful study which the Germans devoted to the needs and tastes of Indian customers. The share of Belgium, which supplied 3·9 per cent of the imports in 1903-4, was reduced to 2·3 per cent, while Java on account of her increased exports of sugar to India shot ahead and occupied the third place, contributing 5·8 per cent of the total imports in 1913-14.

The export trade showed a similar tendency towards diversion from the United Kingdom in the period before the war of 1914-18. At the beginning of the present century, roughly speaking 29 per cent of the exports went to the United Kingdom, 25 per cent to continental Europe, 24 per cent to the Far East and 7 per cent to the United States and the remaining 15 per cent to other countries. By 1914, the United Kingdom's share was reduced to 24 per cent, that of continental Europe rose to 29 per cent, the Far East took only 17 per cent, owing to the fall in the exports of opium and yarn, the share of the United States rose to 9 per cent, and that of other countries to 21 per cent. It will thus be seen that during this period continental Europe gained what the United Kingdom

lost. The loss in the eastern market was made good by the gain in those of other minor countries. Turning to individual countries we find that, apart from the United Kingdom which was the biggest individual buyer of Indian goods, Germany which was third on the list in 1900 rose to the second place in 1914. Japan showed a similar improvement in her buying capacity, and advanced from the sixth place to the third as a buyer of Indian goods. China, on the other hand, lost the second place which she had occupied in 1900 and ranked sixth in 1914.[1]

§17. **Distribution of India's trade during the war period(1914-18).**—During the period covered by the war of 1914-18, while the pre-war tendency of the import trade to move away from the United Kingdom gained in strength, the United Kingdom lost further ground in the Indian market owing to her pre-occupation with the war, the control of the Home Government on her exports and the restrictive effects of high prices. Her share in the import trade came down from 64·1 per cent in 1913-14 to 45·5 per cent in 1918-19. Taking the whole war period, her share declined from the pre-war average of 62·8 per cent to the war average of 56·5 per cent. This, coupled with Germany's exit from the Indian market, created a gap in the import trade, a portion of which was rapidly filled up by Japan and the United States. Iron and steel and hardware previously supplied by the United Kingdom had now to be imported from these countries; while glassware, cotton piece-goods, paper, etc., had to be imported from Japan, and dye-stuffs from the United States. Both these countries made special efforts to study the requirements of the Indian market as Germany had done in the pre-war period, and extended their commercial organization in the country, which in the case of Japan included the establishment of retail stores in the principal Indian towns. The Japanese exchange banks in India also extended special financial facilities to the importers.

On the export side, the tendency was for a temporary return of trade to the United Kingdom and the British Commonwealth as a result of the war-time purchases and special measures taken to facilitate them, including restrictions on trade with neutral countries and the grant of credit facilities to some of the Dominions. All this was reflected in an increase in the share of the United Kingdom in the export trade from 23·4 per cent in 1913-14 to 29·2 per cent in 1918-19. The shares of the United Kingdom and the Commonwealth as a whole increased from the pre-war average of 25·1 per cent and 41·1 per cent to 31·1 per cent and 51·7 per cent (war average) respectively. Germany of course disappeared altogether as a buyer from the Indian market. The shares of France and Belgium were also reduced on account of the occupation of their territories by Germany. Japan and the United States, on the other hand, increased their share from 9·2 per cent and 8·9 per cent in 1913-14 to 12·1 and 13·8 per cent respectively in 1918-19. This increase was due to the privileged position held by these two countries as allies who, moreover, were removed far away from the theatres of war; their increased export trade with India establishing credits for them; and the conscious efforts made by both to develop direct trading relations with India. There was also a general reduction in the demand for Indian produce for normal industrial activity elsewhere. Thus, on the whole, during the war period (1914-18) India had to sell her produce in a restricted market,

[1] See R. M. Joshi, *Indian Export Trade*, pp. 159-60.

and, though she received higher prices for it than before the war, the prices she had to pay for her imports were far higher.

§18. **Tendencies of India's foreign trade after the war of 1914-18.**[1]—After a temporary and partial recovery on the import side in the early post-war period the United Kingdom again experienced a setback, and the progressive decrease in its share in import trade was accentuated, especially in 1930-1 and 1931-2, by the political situation in India. In the latter year her share declined to 35·5 per cent. The United Kingdom had again to experience the competition of foreign countries such as Germany, Japan, and the United States in the Indian market. Growing industrialization in India also contributed to this result. Between 1932-3 and 1933-4 there was an improvement in the position of Great Britain, her share having risen to 41·7 per cent in 1933-4 owing largely to her favourable position in the Indian market under the Ottawa preferences introduced with effect from 1 January 1933. The percentage share of the United Kingdom has since further declined to 38·4 in 1936-7, 30·5 in 1938-9 and only 25·2 in 1939-40.

Japan and the United States naturally lost part of the ground captured by them during the war of 1914-18, Japan receiving a special setback owing to the commercial crisis of 1920-1. Another cause which affected the imports from both countries was the re-appearance of old rivals and the restoration of more normal conditions of competition in the Indian markets. Japan increased her share during the years 1933-4 to 1936-7. The proportion received from Japan showed decreases in 1937-8 and 1938-9, owing mainly to her preoccupation with the war in China. The share of Germany, during the post-war years, especially after 1922-3, showed a remarkable recovery.

On the export side there was a definite tendency towards diversion, as was to be expected after the war of 1914-18, away from the United Kingdom as shown by the decline in her share from the war average of 31·1 per cent to the post-war average of 24·2 per cent. There was a gradual rise, however, and the share of the United Kingdom in the export trade improved considerably after 1928. It increased from 21·4 per cent in 1928-9 to 32·2 per cent in 1936-7 and 34·3 per cent in 1938-9. Indeed, the usual excess of imports over exports in the case of the United Kingdom was transformed in the year 1936-7 into a favourable balance of Rs. 18 crores. Japan showed a striking improvement in her relative position in the export trade, her percentage share advancing from 7·2 to 15·7 per cent in 1934-5 due to the large shipments to that country of raw cotton, metals and ores, gunny bags and shellac. In later years India tended to export less and less to Japan, whose trade was largely regulated by exchange control. Her share in 1939-40 amounted to only 6·9 per cent.

To sum up the general trend of the developments of India's foreign trade during the period after the war of 1914-18, the pre-war tendency of a diversion of both the export and the import trade from the United Kingdom re-asserted itself more forcibly than ever, especially on the side of imports, until 1931-2. After that, there was recovery in her share especially in the export trade of India. Japan and the United States became the most formidable competitors of England in the Indian market. Germany had almost regained her former position in respect

[1] See also Vera Anstey, *Trade of the Indian Ocean*, pp. 74-9.

of imports before the declaration of the 1939-45 war. All these nations commanded an excellent commercial organization for pushing their trade with India; and in this respect they had stolen a march on the United Kingdom. The Ottawa preferences, introduced at the beginning of the year 1933, to some extent helped her to recover her position in India's foreign trade.

§19. **Direction of trade in commodities.**—Tables IV and V (pp. 180-1) indicate the direction and variations of India's trade in some of the more important commodities on the import and export side respectively. The main features regarding the direction of India's trade, most of which are clearly revealed by these tables, may be thus summed up:

(i) *Imports.*—It will be observed from Table IV that the United Kingdom is threatened with competition in almost every line, including those which have hitherto been regarded as preponderatingly British. Though the United Kingdom is still the principal supplier of cotton manufactures to India, her share steadily decreased from 71·3 per cent in 1928-9 to 32·1 per cent in 1939-40, as against 90·1 per cent in 1913-14; and that of Japan increased from 18·3 per cent in 1928-9, to 55·0 per cent during the same period as against 1·8 per cent in 1913-14. In artificial silk, Japan dominated the supplies, her share being 83 per cent in 1939-40 as compared with 66 per cent in 1938-9. The participation of Italy dropped to 12 per cent from 25 per cent in the preceding year. The United Kingdom lost ground during the years following the war of 1914-18 in the supply of iron and steel, machinery and hardware to the United States, Germany, Belgium and even Japan, though she remained the largest single supplier, especially of iron and steel, and machinery.

Burma had a predominant share in the supplies of mineral oils and was reponsible for 48 per cent of the total imports in 1939-40 against 52 per cent in the preceding year. There were also decreases in the supplies from Iran, and those from the U.S.S.R. were practically stopped, while the Bahrein Islands, the United States and Borneo and Sumatra increased their shares. In motor vehicles the United Kingdom lost by about 7 per cent, but the U.S.A. and Canada improved their position from 39 and 13 per cent to 48 and 18 per cent respectively. The shares of Germany and Italy recorded declines.

(ii) *Exports.*—On the export side, the United Kingdom is by far the largest single customer for Indian tea, and took 81 per cent of the total exports in 1939-40; Canada's share improved from 4·2 per cent in 1913-14 to 7·0 per cent in 1939-40. Direct trade in tea with the U.S.S.R. is now insignificant, though Russia absorbed 11 per cent of the total exports of tea in 1913. Raw jute went mainly to the United Kingdom, France, and the United States, while Germany, Belgium and Italy participated to a lesser extent in this trade. In the case of jute manufactures, America was the principal outlet until 1938-9, but her relative share fell from 26·4 in 1938-9 to 22·8 per cent in 1939-40, while that of the United Kingdom increased from 10·4 to 24·9 per cent. The share of Argentina declined from 10·2 to 6·5 per cent. There were slight variations in the shares of Australia and Java. Canada, the Union of South Africa and Japan are other customers for Indian jute manufactures. In raw cotton Japan was the heaviest buyer and accounted for 36 per cent of the total value of the exports in 1939-40 as against 47 per cent in 1938-9,

TABLE IV—DIRECTION OF INDIA'S TRADE : IMPORTS (Percentage)[1]

Dots (..) indicate that the trade is either *nil* or insignificant.

Country	Cotton manufactures		Artificial silk[2]		Iron and steel		Machinery		Hardware		Motor cars, etc.		Mineral oils		Paper and pasteboard	
	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40
United Kingdom ..	90·1	32·1	..	2·8	69·9	45·8	89·8	60·9	57·2	37·9	71·3	29·9	5·7	1·2	56·0	22·3
United States ..	0·4	0·3	..	..	2·6	6·9	3·3	17·0	9·7	14·1	15·1	47·9	56·1	8·5	..	6·9
Germany ..	2·1	0·1	..	0·4	14·5	6·9	5·6	9·4	18·2	21·1	..	1·9	7·3	0·2	17·0	11·6
Belgium	..	0·1	..	..	11·5	9·5	..	1·8	..	1·3	4·5	..	..	..	..	..
Japan	1·8	55·0	..	82·6	..	10·3	..	1·3	1·5	11·0	..	0·3	..	..	..	..
France[3]	..	0·2	..	0·4	..	3·9	..	0·5	..	0·9	4·5	0·4	..	..	..	0·9
Italy	1·5	0·4	..	11·8	..	..	..	..	..	..	..	1·0	..	..	..	..
Netherlands ..	1·6	0·5	..	0·4	..	..	..	..	..	..	..	..	..	..	2·5	4·6
Australia	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Norway	..	..	..	..	..	..	..	..	..	..	..	..	..	..	5·0	16·2
Sweden	..	..	..	..	..	2·5	..	1·8	0·9	6·6	..	..	..	..	3·1	18·2
Canada	..	..	..	..	..	..	..	..	..	..	..	18·0	..	..	..	..
Borneo, Sumatra, etc.[4]	..	..	..	..	..	..	..	..	..	..	..	..	25·1	12·6	..	0·3
Java ..	..	..	..	0·2	..	..	..	..	..	..	..	..	..	..	..	..
Bahrein Islands ..	..	..	..	..	..	..	..	..	..	..	..	..	..	11·3	..	..
Iran	..	..	..	..	..	..	..	..	..	..	..	..	3·7	16·8	..	..
U.S.S.R. ..	..	..	..	..	..	..	..	..	..	..	..	..	0·9	..	..	..
China	0·1	4·6	..	0·7	..	..	..	..	..	..	..	..	..	..	..	..
Switzerland ..	..	1·4	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Austria	..	..	..	..	..	..	..	..	..	..	..	..	..	..	8·3	1·4
Burma	..	..	..	..	..	..	..	..	..	..	..	..	..	48·4	..	..
Percentage of total trade represented by countries shown ..	97·6	94·7	..	99·3	98·5	85·8	98·7	92·7	87·5	92·9	95·4	99·4	98·8	99·0	91·0	82·4
Value of trade (crores of rupees) ..	66·3	14·15	..	4·59	16·0	6·09	7·8	14·67	3·8	2·27	1·5	5·18	4·1	17·13	1·6	3·46

[1] *Review of the Trade of India* (1936-7), pp. 131-3 and (1939-40), pp. 171-3. Figures for 1913-14 relate to imports into India including Burma. Those for 1939-40 *exclude* Burma.

[2] Figures for 1913-14 not available.

[3] Includes Luxemburg in the case of imports of iron and steel, machinery and hardware.

[4] Includes the Straits Settlements and other islands.

TABLE V—DIRECTION OF INDIA'S TRADE. EXPORTS (Percentage)[1]

Dots (..) indicate that the trade is either *nil* or insignificant.

Country	Tea		Jute (raw)		Jute manufactures		Cotton (raw)		Hides and skins (raw and tanned)		Oil-seeds		Food grains	
	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40	1913-4	1939-40
United Kingdom	72·4	80·9	38·0	37·2	6·3	24·9	3·5	17·4	25·9	69·1	22·2	37·2	20·7	7·9
Canada	4·3	7·0	..	0·5	..	3·6	..	..	..	..	..	..	..	..
Australia	3·1	0·9	..	0·5	10·6	7·5	..	..	..	..	..	..	..	..
United States	0·7	3·1	11·9	10·2	41·5	22·8	..	3·9	24·3	20·1	1·2	3·0	..	..
Germany	..	0·2	21·8	4·6	..	..	14·6	1·5	20·3	1·1	16·0	6·4	7·8	1·0
Japan	..	..	..	2·2	0·5	0·1	47·2	35·7	..	0·1	..	0·9	3·8	..
France	..	..	9·9	14·5	..	0·2	..	8·7	..	2·2	31·4	12·2	..	..
Italy	..	..	5·5	5·1	..	..	7·7	1·5	5·3	1·0	5·0	2·4	..	..
Belgium	..	..	0·5	5·0	..	0·4	10·3	2·1	..	0·3	16·0	5·5	..	..
Ceylon	1·6	2·5	..	..	..	0·1	..	0·2	..	0·1	..	0·7	11·5	28·0
U.S.S.R.	11·1	..	..	0·1	..	..	..	..	..	..	..	..	..	..
Iran, Arabia, etc.	1·2	2·6	..	..	..	0·3	..	..	..	0·6	..	0·2	5·6	13·4
Java	..	..	..	..	2·5	2·5	..	..	..	..	..	..	..	..
Argentine Republic	..	..	..	1·8	10·4	6·5	..	..	..	..	..	..	..	..
China	..	..	..	..	..	..	1·7	22·2	..	..	..	..	..	..
Spain	..	..	2·8	3·0	..	..	..	0·4	2·8	..	..	0·1	..	..
Netherlands	..	..	..	..	..	..	..	0·7	3·3	0·3	1·0	13·8	6·8	0·4
Straits Settlements	..	..	..	..	..	..	..	..	..	0·2	..	1·0	6·7	5·3
Sumatra and Java	..	..	..	..	..	..	..	..	..	0·1	..	0·1	1·0	..
Egypt	0·5	0·2	..	0·2	2·1	2·3	..	..	..	..	..	..	..	..
Union of South Africa	..	0·2	..	..	1·7	3·8	..	..	..	..	..	..	..	..
Thailand	..	..	..	..	1·6	2·0	..	..	..	..	..	..	..	..
Percentage of total trade represented by countries shown ..	94·9	97·6	90·4	84·9	77·2	77·0	85·0	94·3	81·9	95·2	92·8	83·5	69·9	56·0
Total value of trade (crores of rupees)	15·0	23·29	30·8	19·73	28·2	48·69	41·0	30·11	15·9	11·04	25·6	11·84	45·1	5·07

[1] *Review of the Trade of India* (1936-7), pp. 133-4, and (1939-40), p. 174. Figures for 1913-14 relate to exports from India including Burma. Those for 1939-40 *exclude* Burma.

while the share of China advanced from 7 per cent to 22 per cent. The share of the United Kingdom was 17·4 per cent in 1939-40. In food grains, Ceylon was the best customer for Indian rice, and accounted for 28 per cent of the total value of food grains exported in 1939-40. The United Kingdom, Straits Settlements, Iran, Arabia, and Asiatic Turkey were other large customers for Indian food grains. In oil-seeds, France used to take more groundnuts from India than any other country. The United Kingdom, Germany, Italy, and the Netherlands were other principal countries which imported oil-seeds from India. In hides and skins the United Kingdom and the United States were the largest buyers.

§20. **Indo-Burma trade.**—Prior to April 1937, Indo-Burma trade was treated as coasting trade. With the separation of the two countries from 1 April 1937, the trade of the one with the other began to be treated as foreign trade. The trade relations between the two countries were, until the conclusion of the Trade Agreement (April 1941), governed by the India and Burma (Trade Regulation) Order, 1937. The aggregate value of the trade between the countries during 1939-40 amounted to Rs. 44,85 lakhs as compared with Rs. 35,45 lakhs in 1938-9. India's principal imports from Burma consisted of rice (Rs. 16,65 lakhs), mineral oils (Rs. 7,91 lakhs) and teak wood (Rs. 1,95 lakhs). These together represented 87 per cent of the total imports from Burma in 1939-40. Imports of vegetables were valued at Rs. 31 lakhs.

On the export side, cotton and jute manufactures were the most important items, which taken together accounted for Rs. 5,92 lakhs or 48 per cent of the total exports of Indian merchandise (Rs. 12,30 lakhs) to Burma in 1939-40. Among other items of exports to Burma mention may be made of iron and steel (Rs. 88 lakhs); tea (Rs. 21 lakhs); and sugar (Rs. 2 lakhs).

§21. **Changes in direction of trade during World War II and after.**—For obvious reasons the trade with the European continent practically ceased during the war. The export of manufactured goods increased and that of raw materials decreased.

The position of the United Kingdom in the import trade of India which had been gradually deteriorating since the turn of the present century weakened further during the war. Imports from the U.K. fell from Rs. 46·5 crores in 1938-9 to Rs. 29·53 crores in 1942-3.

The value of exports to the United Kingdom was more than maintained. The result was a reversal of India's position as regards her balance of trade with the United Kingdom. Before the war India imported more from than she exported to the United Kingdom. Subsequently, however, the balance of trade was in India's favour. In fact it was much greater than is apparent from the above figures, if account is taken of the large war-time purchases which the British Government made in India and which were excluded from the official export figures. This unprecedented favourable balance of trade with England enabled India (i) to discharge her current obligations in England by direct exports, (ii) to repatriate India's sterling debt and thus to reduce the volume of India's obligations in England and (iii) to accumulate large sterling balances held in London in the name of the Reserve Bank of India. The table on p. 184 shows the principal changes in the direction of India's trade and balance of trade with important countries

for the two years 1944-5 and 1945-6 and compares them with the pre-war year 1938-9. During 1945-6 India's favourable trade balance was converted into the unfavourable balance of Rs. 10 lakhs. Between 1942-3 and 1945-6, imports increased much more rapidly than exports. Out of the total imports of Rs. 240,49 crores, the British Empire sent 42·3 per cent of the goods, the United Kingdom alone accounting for a quarter of the total, and Australia coming next in order of importance. The share of foreign countries amounted to Rs. 138,66 crores in 1945-6 representing 57·7 per cent of the total trade as compared to 41·9 per cent in the pre-war year 1938-9. In spite of exchange difficulties, the imports from the U.S.A. increased from 6·4 per cent in 1938-9 to 28 per cent in 1945-6. The next important exporter to India was Iran, the principal export commodity being oil. Egypt came next with a share of Rs. 15,10 lakhs—mainly raw cotton.

Our exports in 1945-6 amounted to Rs. 240,39 crores, the share of the British Empire being 55·5 per cent. The share of the United Kingdom dwindled from 34·1 per cent in 1938-9 to 28·2 per cent in 1945-6, although there was an increase in absolute value from Rs. 55,51 lakhs to Rs. 67,91 lakhs. Among foreign countries, the U.S.A. absorbed the highest value of our goods worth Rs. 61,62 lakhs, nearly half of which was on account of cashew nuts.

India had a favourable balance of trade amounting to Rs. 31,77 crores with the Commonwealth countries and an adverse balance of Rs. 31,87 crores with foreign countries.

§22. **Entrepôt (re-export) trade of India.**—The entrepôt trade of a country consists of the re-export of articles previously imported, the country in question serving merely as a convenient distributing centre. From very early times India has had a certain amount of entrepôt trade, principally by reason of her geographical situation. Being situated in the centre of the Eastern hemisphere she is a convenient halting-place for the trade between the Far East and the West. Thus in the old times, 'this section of trade consisted chiefly of the import of silk goods and porcelain from China, pearls from Ceylon, precious stones and spices from the islands of the Eastern Archipelago—all for purposes of re-export to countries of the west; Venetian glass and the like from countries of the west to be re-exported to the east'.[1] In more recent times India's entrepôt trade was seen steadily to expand till a short while ago, showing an increase from Rs. 5·80 crores in 1882-3 to Rs. 18·04 crores in 1920-1. Since the latter year, however, it has fallen, and amounted to Rs. 13½ crores in 1924-5, Rs. 10½ crores in 1925-6, Rs. 9½ crores in 1927-8, Rs. 7 crores in 1929-30, Rs. 4·65 crores in 1931-2, and Rs. 3·22 crores in 1932-3. In 1933-4 the re-export trade in foreign merchandise improved slightly from Rs. 3·22 crores to Rs. 3·42 crores. The years 1934-5 and 1935-6 saw a further expansion, the value of re-exports having risen to Rs. 3·55 crores and Rs. 3·76 crores respectively. It showed a noticeable increase in the year 1937-8 when it amounted to Rs. 8·28 crores. It once again declined to Rs. 6·42 crores in 1938-9 but advanced to Rs. 9·64 crores in 1939-40. There were further advances to Rs. 11·81 crores in 1940-1 and Rs. 15·33 crores in 1941-2. The percentage shares of the principal countries in the re-export trade of India in the year 1941-2 were as follows:—United States 8 per cent; Burma 8 per cent; Aden and Dependencies 6 per cent; and Arabia 5 per

[1] K. T. Shah, *Trade, Tariffs and Transport in India*, p. 92.

TABLE VI.—DIRECTION OF TRADE (*in lakhs of rupees*)[1]

	1938-9			1944-5			1945-6		
	Imports	Exports (excluding re-exports)	Balance (excluding re-exports)	Imports	Exports (excluding re-exports)	Balance (excluding re-exports)	Imports	Exports (excluding re-exports)	Balance (excluding re-exports)
I. British Empire:—									
United Kingdom	46,49	55,51	+ 9,02	40,17	61,71	+ 21,54	61,07	67,91	+ 6,84
Percentage	30·5	34·1	..	20·0	29·2	..	25·3	28·2	..
Burma	24,35	10,03	− 14,32	13	..	− 13	42	12	− 30
Ceylon	1,18	5,09	+ 3,91	3,72	19,16	+ 15,44	3,73	16,74	+ 13,01
Australia	2,41	2,97	+ 56	10,25	14,67	+ 4,42	7,35	10,56	+ 3,21
Canada	91	2,14	+ 1,23	3,65	6,90	+ 3,25	5,59	6,69	+ 1,10
South Africa	35	1,49	+ 1,14	2,98	11,88	+ 8,90	2,67	7,21	+ 4,54
Other countries	12,87	8,14	− 4,73	17,10	23,57	+ 6,47	21,00	24,37	+ 3,37
Total, British Empire	88,56	85,37	− 3,19	78,00	137,89	+ 59,89	101,83	133,60	+ 31,77
Percentage to total trade	58·1	52·4	..	38·8	65·3	..	42·3	55·5	..
II. Foreign countries:—									
United States	9,78	13,88	+ 4,10	50,46	44,79	− 5,67	67,40	61,62	− 5,78
Percentage	6·4	8·5	..	25·1	21·2	..	28·0	25·6	..
Japan	15,41	14,59	− 82	..	..	..	..	..	..
Egypt	2,19	1,23	− 96	17,38	3,36	− 14,02	15,10	2,82	− 12,28
Iran	3,49	78	− 2,71	49,33	2,74	− 46,59	46,28	1,52	− 44,76
Other foreign countries	36,39	47,72	+ 11,33	5,81	22,26	+ 16,45	9,88	40,83	+ 30,95
Total, foreign countries	63,77	77,42	+ 13,65	122,98	73,15	− 49,83	138,66	106,79	− 31,87
Total trade	152,33	162,79	+ 10,46	200,98	211,05	+ 10,07	240,49	240,39	− 10

[1] *Indian and Pakistan Year Book*, 1949, p. 334.

cent; Anglo-Egyptian Sudan, Iraq and Egypt 4 per cent each, and Ceylon 3 per cent. The bulk of the re-export trade passed through Bombay and Sind, which accounted for 43 per cent and 45 per cent respectively, Bengal coming next with 11 per cent only.

The re-export trade is mainly in manufactured articles imported from the Western countries, especially cotton textiles which are taken by Iran, Muscat and East Africa. The principal articles exported to Western countries are raw skins and wool. A certain amount of fur skins from Iran are exported from Bombay, which also re-exports pearls previously imported from the Bahrein Islands, Muscat, etc.

Though India will always act as a distributing centre to a certain extent, particularly for those Asiatic countries which have no seaboard of their own and to which the Indian ports afford the nearest approach for maintaining trade relations with other countries, the prospects of the entrepôt trade of India are not bright in view of the growing tendency towards the establishment of direct trade relations among the various countries, lessening their dependence on India as an entrepôt.

§23. **Balance of trade.**—A large surplus of exports over imports of private merchandise used to be a normal and much-noticed feature of India's foreign trade. Occasionally India has experienced what is called an adverse balance of trade, that is to say, there has been an excess of imports of merchandise over exports, for example in the years 1920-1 and 1921-2 (see §6 above). The normal excess of exports over imports (the so-called favourable balance of trade) was liquidated partly by importation of precious metals—gold and silver—and partly by payment of interest and other Home Charges, which may be described as India's invisible imports. India's average credit balance in merchandise was Rs. 78 crores in the five pre-war years, 1909-10 to 1913-14, Rs. 76 crores during the five war years, and Rs. 53 crores during the five post-war years ending 1923-4. During the next quinquennium ending 1928-9 the average rose to Rs. 1,13 crores, but it dropped to the low figure of Rs. 43 crores during the five years ending 1933-4. The year 1932-3 was the least favourable, the credit balance dropping to a little over Rs. 3 crores. In 1933-4 the balance in favour of India rose to Rs. 35 crores. But the following year (1934-5) saw a deterioration of the position, the balance dropping to Rs. 23½ crores. In 1935-6 it rose to Rs. 30½ crores and in the following year (1936-7) was more than doubled, being Rs. 77¾ crores. In 1937-8 the surplus of India's (excluding Burma) exports over imports of private merchandise declined to Rs. 16 crores as compared with Rs. 51 crores in the preceding year. The figures for India including Burma were respectively Rs. 43 crores and Rs. 77¾ crores. The greater decline in imports than in exports in 1938-9 under the influence of the 'recession' resulted in a betterment of the trade balance, which stood at about Rs. 17½ crores as compared with Rs. 16 crores in the previous year. The trade balance position substantially improved in the year 1939-40 as a result of the war. Thus the surplus of exports over imports was nearly Rs. 48 crores as compared with about Rs. 17½ crores in 1938-9. In 1941-2, it was Rs. 107·9 crores and in 1942-3, Rs. 91·94 crores. As these figures do not take into account the war purchases of His Majesty's Government in India, the actual position was more favourable than these figures suggest. The favourable balance of trade

was Rs. 86·17 crores in 1943-4, and Rs. 50·65 crores in 1944-5. In 1945-6, owing to a freer import policy, there was actually an adverse balance. In the next year, however, the balance of trade was again favourable to the extent of Rs. 41 crores. During the year ended March 1949, imports were valued at Rs. 518 crores and exports, Rs. 423 crores. The difference of Rs. 95 crores, however, does not include the adverse balance in our trade with Pakistan. The figure for imports is also an understatement as the food imports were less than fully valued in the import trade figures. Stricter restrictions on imports and special encouragement to exports which have been helped by the recent devaluation of the rupee in September 1949, has brought the problem of trade deficit under control. The Government of India's import policy has latterly been governed mainly by the trend of balance of payments. At first the problem was to regulate imports so as to prevent the deficit in balance of payments from exceeding the amount of sterling balances released by agreement in any given year. While from this point of view it was necessary to keep imports strictly limited a policy of liberalizing imports seemed indicated to relieve inflationary pressure. Import restrictions were accordingly relaxed during the latter part of 1948. Another object of this move was to meet the shortage of industrial and essential consumer goods. The result was a considerable increase in imports. The exports on the other hand declined owing mainly to a fall in American demand for jute and jute manufactures. There was consequently a large adverse balance in payments during the period from July 1948 to June 1949 leading to an overdrawal of about £81 million from the sterling balances. Measures reversing the policy of liberal imports were therefore introduced in May 1949 when the Open General Licence XI for the soft currency areas was cancelled. Following this cancellation, a revised list of commodities which could be imported without licence from soft currency areas, provided the commodities were manufactured or produced in those areas, was issued under the name of Open General Licence XV.[1] After July 1949 further restrictions were imposed on the licensing of imports. Dollar licensing was totally suspended from the last week of June 1949 to the first week of September 1949. The goal of trade policy at present is to increase exports by efficient production and sale at competitive prices and decrease or stop imports, especially of food grains and the main industrial materials.

The trade depression of 1929-33, the restrictions on the free movement of goods, the changes in the volume and character of international trade, and the business recession of 1937-8 had an adverse influence on India's balance of trade. The separation of Burma from British India from 1937-8 also reduced the favourable trade balance of India. While in itself a low credit balance need not have caused perturbation, the matter was of significance in the case of India, which had large overseas obligations to meet. The alleviating circumstance in this connexion has been the exports of gold from India which first came into evidence in 1931. The change in India's position from a gold-importing country to a gold-exporting country has been one of the most important factors affecting her international trade account. The normal absorption of the precious metals was first checked in 1931-2, when there was a net export of gold to the value of Rs. 58 crores. In 1932-3 and

[1] See *Indian and Pakistan Year Book*, 1949, pp. 331-2.

1933-4 there were net exports to the value of Rs. 65½ and Rs. 57 crores respectively. In 1934-5 the net exports amounted in value to Rs. 52½ crores. The exports of gold declined to Rs. 37⅓ in 1935-6, to Rs. 28 crores in 1936-7, Rs. 16⅓ crores in 1937-8, and Rs. 13 crores in 1938-9. It will be seen that with an increase in the favourable balance of trade in merchandise there was a contraction in the export of gold. In the year 1939-40, however, the net exports of gold increased to Rs. 34⅔ crores, although the trade balance showed an improvement. This was due mainly to the sharp increase in the world price of gold owing to conditions created by the war. In the same year the net imports of silver rose from Rs. 1·75 crores in 1938-9 to Rs. 4·74 crores in 1939-40. The visible balance of trade, as measured by statistics of private merchandise and treasure, was in favour of India to the extent of Rs. 79 crores in 1939-40 as compared with Rs. 29 crores in 1938-9 and Rs. 30 crores in 1937-8. The total value of gold exported from India, since England went off the gold standard in 1931, amounted to Rs. 351·40 crores at the end of December 1939.

§24. **Credit and debit items in India's balance sheet.**—In a proper balance of accounts of payments there must be an exact equivalence between exports and imports, and this will be seen to be established, if we could take into account not only the visible items, that is to say, those items which are recorded in the customs returns or in other published statistics, but also the invisible items, that is to say, those items which are not thus recorded. We shall now consider the items that have to be taken into account for a complete international balance sheet.

Credit	Debit
1. Exports of merchandise.	1. Imports of treasure.
2. Loans raised abroad.	2. Interest on loans raised abroad.
3. Remittances by foreigners to India for the support of schools and missions and for the relief of famines and other charitable purposes.	3. Repayments of loans previously incurred.
4. Tourists' expenses.	4. Remittances abroad by European merchants, lawyers, Government officers, etc.
	5. Profits of foreign banks and insurance companies and freight charges paid to foreign shipping companies.
	6. Expenditure on Government account abroad in connexion with furlough pay, pensions, stores, bullion, etc., purchased for the Government of India (Home Charges).
	7. Remittances to Indian students and tourists abroad.

(i) Imports and exports of merchandise. Under this head, as we have already seen, India is normally a creditor country. (ii) With regard to treasure, however, India until 1930-1 used to import more than she exported and therefore she was a debtor on this account. Since 1931-2, as pointed out above, the situation has been reversed and she has been exporting large amounts of gold, which makes her a creditor on this account. (iii) Loans offered or received from abroad. While a loan is

being carried out, the nation which contracts the debt is the creditor and the nation which advances the loan is the debtor. Under this head India was until recently a creditor country as she was raising large loans in England from time to time. (iv) The annual interest on capital already invested has the opposite effect, making the borrowing country a debtor and the lending country the creditor, and in so far as India had to make annual remittances of interest on the loans she had contracted she was a debtor under this head. (v) The repayment of the loan itself also makes the borrowing country the debtor and the lending country the creditor. And as India was constantly paying off portions of her foreign debt in addition to paying the interest year after year, she was under this head a debtor country. The repayment of the loan may take the form of Indians purchasing the rupee paper held in England or of conversion of sterling debt into rupee debt, thus bringing the debt home.[1] The effect of this is the same, that India's foreign obligations are lessened thus far. (vi) The earnings of Indians living abroad and of foreigners residing in India, so far as they are remitted in each case to their native country by the parties concerned. In the former case India is a creditor and in the latter she is a debtor. But on the whole, under this head India is a debtor. The remittances abroad of European merchants and businessmen, bankers and Government officials far outweigh the remittances to this country of Indian merchants and coolies residing outside India. (vii) The profits of foreign banks and shipping and insurance companies. India's payments under the head of banking profits, shipping freights and premiums of insurance represent India's indebtedness to that extent. (viii) The remittances of money by foreigners for benevolent purposes to the country or donations sent abroad by the country make it a creditor in the former case and a debtor in the latter. Under this head India is a creditor country, because she receives more money from Europe and America for the support of missions and missionary schools in India as well as in the form of occasional subscriptions raised abroad for the relief of famine in India and other calamities, than she sends to foreign countries for similar purposes. (ix) The expenditure of a nation's Government abroad will make it a debtor to that extent, and, conversely, the expenditure of other Governments in a country will make it so far a creditor.[2] On this account India is normally a debtor as she had to spend large amounts of money in England by way of furlough pay and pensions of European officers who had served in India, and for the purchase of stores, etc. She had also to pay the British Government for various kinds of expenditure incurred by the latter for India. All this expenditure on Government account in England was included under Home Charges. (x) The payment of tributes or indemnities obviously makes the paying country a debtor and the receiving country a creditor. As India neither pays nor receives a tribute or indemnity, this heading has to be altogether ignored. (xi) The expenditure of foreign tourists in India and Indian tourists abroad. Under this head India is a creditor because the number of foreigners visiting India

[1] The repatriation of India's sterling debt has fundamentally altered her position in respect of her foreign loans. See ch. xii.

[2] For example, the large recoverable expenditure the Government of India incurred on behalf of the British Government during the war of 1914-18 and again in the war of 1939-45.

for sight-seeing is far greater than the number of Indians visiting foreign countries. (xii) On the other hand, India is a debtor to the extent of the remittances for the education of Indian students abroad.

For a complete balance sheet, therefore, we should have to reckon in all these items, and if that could be done the two sides of the account must balance each other.

The statement on p. 187 shows India's position as it was until very recently. On the right-hand side we have India's debit items, that is, those on account of which India had to pay more money abroad than she receives: and on the left-hand side we have the credit items, that is, those on account of which more money was owing to India from foreign countries than she owed to foreign countries.

§25. **The 'drain' defined.**—India's habitual excess of exports over imports gave rise to the 'drain' theory. For all the outgoings represented by excess of exports, India received some kind of return, and they could all be accounted for by various items of receipt. However, as the Spanish proverb has it, 'the accounts are all right but the treasury is empty'. The real point was not whether some kind of return was received, but whether the return was in every way satisfactory.

§26. **The Home Charges.**—India's excess of exports over imports was largely accounted for by Home Charges.

The following figures show the great growth of the Home Charges between 1859-60 and 1933-4.[1]

Gross Sterling Expenditure in England

Year	Amount	Year	Amount	Year	Amount
1859-60	£ 5,042,945	1913-14	£ 20,311,673	1928-9	£ 29,744,993
1869-70	7,677,850	1918-19	23,629,495	1929-30	31,558,715
1879-80	14,543,277	1922-3	31,860,179	1930-1	31,423,147
1889-90	14,848,923	1924-5	31,888,776	1931-2	30,899,333
1899-1900	16,392,864	1926-7	29,507,472	1932-3	29,556,401
1909-10	19,122,916	1927-8	28,864,765	1933-4	28,862,177

We will exclude from the present discussion the payment on account of stores purchased on behalf of India in England, because the stores were a material equivalent and figured in the returns for imports. We have already seen that it is an arguable point whether these purchases of Government stores could not have been effected more cheaply and whether a larger reliance on the Indian market for their supply was not feasible. But in the 'drain' controversy we are concerned with that part of India's debits in any given year for which (i) *in that year* no equivalent, material or immaterial, was received, as well as (ii) that part for which the equivalent received in that year was *immaterial*, i.e. not in the form of material goods or money.

§27. **Payments in connexion with foreign loans.**—One of the most important items in Home Charges was interest on debts which arose in consequence of

[1] Figures up to 1918-19 have been taken from Shah, *Sixty Years of Indian Finance* (second edition), pp. 187-8, and those for subsequent years from the *Statistical Abstract*, 1926-7 and 1933-4.

Government borrowings in England for financing railways, irrigation works, etc. The various questions relating to the employment of foreign capital in this country have already been discussed,[1] and it should now no longer be necessary to emphasize that borrowing money from abroad is not necessarily an evil, but that, on the contrary, foreign loans are often to be regarded as 'highly satisfactory incidents of economic development'. Many countries which are rich in national resources but poor in capital find it necessary and profitable to borrow from other countries, and some of the debtor countries like Canada are amongst the most prosperous in the world and are becoming more and more prosperous with the help of foreign capital. It is obviously absurd to describe the interest on these loans as a 'drain', and since it is the interest on foreign debt that figured most prominently in the Home Charges as well as in the rest of India's disbursements abroad, Sir Theodore Morison proposed to substitute the colourless expression 'foreign payments' or 'net foreign payments' for the misleading word 'drain' which suggests that these payments are harmful to the country. He argued that this part of India's indebtedness at any rate could not be regarded as a drain on the country's resources caused by her political connexion with England. For even if she had been outside the Empire it would have been necessary for her to raise these loans for the purpose of developing her resources. The fact that these debts were incurred in England had nothing whatever to do with India's political subjection to England. The debts were raised in London because London happened to be the cheapest money market in the world. It was further contended that the political connexion with England, far from being a handicap to India, was of distinct advantage to India in this respect, because it raised her credit abroad and enabled her to borrow on more advantageous terms than would have been possible otherwise. The British Government did not directly guarantee India's credit, but had improved India's credit abroad by ensuring a stable administration and by promoting the economic development of the country. In this connexion we might restrict ourselves to the consideration of the most representative as well as the most important of our borrowings, namely those for railway construction in this country. The various issues that would be relevant are, whether all the railways that have been built were required in the best interest of the country, and whether in some cases the need for transport facilities could not have been met more cheaply by other modes of transport such as roads and canals whether to some extent the expenditure on railways was not at the sacrifice of other more deserving claimants for public funds like irrigation works; whether the inducements offered to foreign capital in the shape of guaranteed rates of interest were not excessive; and whether the railway system was worked as efficiently and cheaply as possible with a consistent regard for national interests. All these questions have already been discussed and we need merely repeat here that in all these respects mistakes were committed, and our payments in connexion with these loans cannot be said to have been compensated fully by economic equivalents. We may admit that the railways have been on the whole the 'harbingers of economic prosperity' in India and that the actual advantages, direct as well as indirect, more than outweighed the cost of construction. But the

[1] See vol. I, ch. xiii.

real point at issue is whether these great benefits from railways were not secured at a needlessly heavy cost.

Payments in the form of interest and profits on the foreign capital which had sought investment in this country without Government intervention and mediation did not appear under the Home Charges, but they accounted for a substantial portion of our excess of exports. Here again the question resolves itself into a discussion of the advantages and disadvantages of foreign capital in India, and we can only refer the reader to the relevant sections where this subject has been treated.[1] There we had occasion to note that along with some great and undoubted advantages, certain serious disadvantages have resulted from the unrestricted admission of foreign capital, and therefore the statement that 'India illustrates in its most obvious form the advantage of borrowing foreign capital',[2] cannot be accepted without reservation.

§28. **Civil and military services.**—We now come to that part of our payments which is made in respect of civil and military services.

As regards the civil services there is no doubt whatever that India's expenditure was much higher than it need have been by the employment of Europeans in larger numbers and on higher remuneration than necessary. While the employment of Europeans in many cases involved a needless burden on the taxpayer, their experience was lost to the country when they retired. The denial of his birthright of the Indian to be preferred served to embitter Indo-British relations.

In connexion with the military charges, the principal grievance, was that the strength of the army maintained in India was above her real requirements.[3] Its size, personnel and organization were matters determined by British Imperial rather than purely Indian considerations. Although the Assembly repudiated the suggestion underlying the Report of the Esher Committee of 1919 that the Indian Army was to be regarded as part of the total armed forces of the Empire, it was frequently used for Imperial purposes, and the contention that therefore part of India's military expenditure should have been borne by England was perfectly reasonable.

§29. **Profits of bankers, and of shipping and insurance companies.**—Other services than those noticed above for which also India had to make a payment abroad and which were not exhibited under the Home Charges were those of foreign bankers, European shipping and insurance companies, etc. Even wealthy countries sometimes find it advantageous to buy such services from foreign nations. For example, the United States used to be largely indebted, at least before 1914, to the principal European Powers for marine transport service, banking, insurance, and other financial and commercial services. One could however speak of a 'drain' in so far as these services were forced on the country by England, were unduly expensive and hindered the natural development under which the Indian people could have done much of this work for themselves.

§30. **Some basic assumptions of the 'drain' controversy.**—As a set-off against the various losses incurred by India on account of the 'drain' it was some-

[1] See vol. I, ch. xiii, §§ 19-25.

[2] See Sir T. Morison, *The Economic Transition in India*, p. 218.

[3] See ch. xii, for detailed discussion of the defence expenditure.

times urged that, after all, England had conferred on India the inestimable boon of peace and had made possible an orderly development of the country in all directions and that, therefore, India's losses due to the 'drain' were as dust in the balance when weighed against these blessings. On this plea, however, it would have been possible to justify every kind of Government extravagance and unfairness. The advantages to India of the British connexion, such as they were, were not capable of being precisely measured. They were therefore out of place in a discussion occupied with concrete and calculable items, just as much as the incalculable, though none the less real, advantages which England derived from India. It was possible to compute roughly the advantages which British business men derived from the scope which India offered for their activities and enterprise. But by what calculus could we estimate the gain to England from the enormous increase in her international prestige owing to her possession of India; or how could we fix the value, in terms of pounds, shillings and pence, of the glow of pride and power which Englishmen felt when they contemplated their Indian empire; or of the value of India to England as an unrivalled field for the training of her soldiers, statesmen and administrators? The question of the 'drain', if it was going to lead to any useful conclusions, had to leave out of consideration all impalpable elements.

The analysis undertaken in connexion with the 'drain' theory was useful as indicating various directions of urgent reform, and pointed to the existence of a number of real grievances. It did not, however, furnish anything like a complete explanation of Indian poverty. The first Indian thinker to see the necessity of emphasizing many other more important causes was Ranade, who was a path-breaker in this as in so many other matters. Later writers perhaps did not always show Ranade's insight and his exquisite sense of proportion.

§31. **Land frontier trade.**—India has an extensive land frontier (about 6,000 miles) on the north-west and north-east, considerably exceeding her sea-coast in length. But at many points it offers great difficulties for commerce owing to obstacles such as dense and impenetrable forests and inaccessible mountains. As there were very few openings or passes on the north-west frontier, communication with trans-frontier countries was difficult. In our historical survey of India's foreign trade we have already drawn attention to the ancient character of her land frontier trade, which was fairly brisk during the Mogul period. In more recent times, the position in respect of trans-frontier communications has been considerably improved, especially on the north-west frontier. Though the principal motive in laying out the frontier railway was strategic, it also served as an artery of commerce. The principal trans-frontier countries with which India had trading connexions were Afghanistan, Central Asia, Iran, Nepal and Tibet.

(i) *Trade at stations adjacent to the land frontier routes.*—The system of registration of the frontier trade of India, until it was modified in April 1941, fell under two heads: (*a*) Trade at stations adjacent to the land frontier routes, and (*b*) Indo-Afghan trade. Under the first only the traffic in selected commodities at certain railway stations adjacent to the more important trade routes across the frontier was registered. It may be assumed that a high percentage of the traffic recorded related to frontier trade. The principal commodities imported from the trans-frontier countries were foodstuffs such as wheat, gram, pulse, and rice; raw wool;

raw jute, tobacco, linseed, mustard, rapeseed, etc. By far the most important exports are cotton goods, foreign and Indian; cotton yarn; husked rice and other grain pulse; sugar; raw cotton; iron and steel (including hardware and cutlery); petroleum; leather manufactures; silk goods; tea; salt; tobacco, etc.

(ii) *Indo-Afghan trade.*—Separate statistics of trade between India and Afghanistan, which are available since 1937-8, were registered at Thal, Chaman and Torkham. With effect from 1 April 1941, the trade between India and Afghanistan as registered at Nok-kundi was also included. One of the principal features of the Indo-Afghan trade was the existence of a large volume of transit trade through India. The principal items of imports into India from Afghanistan were skins and furs, fruits, nuts and vegetables, which together accounted for 86 per cent of the imports in 1941-2. Almost the entire quantity of skins and furs was intended for export to foreign countries. Similarly, a large quantity of fruits and nuts was ultimately sent abroad. Among the principal articles of export to Afghanistan, living animals, boots and shoes, leather and cement were mostly of Indian origin, while there was keen foreign competition in such commodities as iron and steel, cotton manufactures and tea. In regard to exports of instruments, apparatus, appliances and parts thereof, machinery and mill-work, and sugar, India had only a small share.

(iii) *Indo-Iranian trade.*—The principal items of imports in order of importance were fruits, nuts and vegetables, woollen carpets and rugs, spices, skins and furs. The principal items of export to Iran by the land route were tea, sugar, wheat and jute.

§32. **International trade and economic prosperity.**—The aggregate volume of India's trade is sufficiently large to entitle her to the fifth place among the countries of the world.[1] The great increase in India's foreign trade in modern times owing to the extension of facilities of railway and steamer transport must not, however, be regarded as a sign of industrial pre-eminence as in the case of the industrially advanced countries of the world, but at most as a necessary preliminary to it.[2] If India develops her own manufactures, this may result, at least in the beginning, in a considerable diminution of her foreign trade, as she will herself be producing the manufactures which she at present imports from abroad, although the greater likelihood is that while the volume of her foreign trade might remain the same or even increase, its composition will be different. It may also happen that in the future her manufactures will develop to such an extent that, after replacing foreign manufactures in the home market, they will overflow her boundaries and spread in the outside world. In fact India's case may be cited in illustration of the uncertain connexion between foreign trade and economic prosperity.[3]

INTERNAL TRADE

§33. (i) **Coasting trade.**—We have already indicated the present position and

[1] In *per capita* trade, India stands very nearly at the bottom. It is obvious that in the case of a large country like India, with a high population, a much more considerable increase in the volume of the total trade is required to show a given amount of growth per head than in the small countries. It may be added that generally speaking it will be found that international exchange is of far greater importance to small than to big nations.

[2] See vol. I, ch. v, 'Economic Transition in India'.

[3] On this point read A. Marshall, *Industry and Trade*, p. 25.

the future importance to India of her coastal trade in our discussion of the proposal to reserve the coastal trade for Indian shipping. The coastal trade may be regarded as a part of the inland trade of the country, though it also includes a small amount of foreign trade.[1]

The following table shows the value of private merchandise (Indian and foreign) imported into and exported from the several maritime provinces of British India from and to Indian ports (British and foreign).

Coasting Trade (in thousands of rupees)[2]

	1918-19		1937-8		1939-40	
	Imports	Exports	Imports	Exports	Imports	Exports
BENGAL ..	1416,28	1146,70	858,21	541,01	751,95	401,19
ORISSA ..	24,33[3]	10,67[3]	13,24	9,24	8,01	16,66
BOMBAY ..	3860,35	2134,04	1440,54	2046,96	1208,29	1703,22
SIND ..	809,05	602,73	855,48	980,84	765,13	785,00
MADRAS ..	952,06	858,06	1083,65	787,23	807,03	659,21
BURMA ..	1695,11	2022,48	..	..	..	..
Total ..	8757,18	6774,68	4251,12	4365,28	3540,41	3565,28

Including the value of the exports and imports of Government stores and of treasure, the total coastal trade was valued at Rs. 166,59 lakhs, Rs. 161,84 lakhs and Rs. 87,02 lakhs in 1918-19, 1935-6 and 1937-8 respectively. The figures for subsequent years have been Rs. 55,45 lakhs in 1938-9, and Rs. 69,96 lakhs in 1939-40. Most of the coastwise trade of India is at present in British hands.[4]

As previously pointed out, with the separation of Burma from British India from 1 April 1937, the trade between the two countries, which in pre-separation days was treated as coasting trade, is now considered as foreign trade. This accounts for the big decline in value of coasting trade in 1937-8.

The total foreign and coastwise trade (imports and exports) of the eight principal ports of India in 1937-8 is shown in the table given below.

[1] Figures relating to imports and exports for the years prior to 1937-8 relate to British India including Burma. In 1937-8 out of the total value of private merchandise imports, viz. Rs. 42·51 crores, Indian merchandise was valued at Rs. 37·56 crores and foreign merchandise at Rs. 4·95 crores; and similarly, out of a total value of exports of Rs. 43·65 crores, Indian merchandise was valued at Rs. 37·15 crores and foreign merchandise at Rs. 6·50 crores.

[2] See *Statistical Abstract for British India* (1937-8), Table No. 265.

[3] Includes Bihar.

[4] 'About 7 million tons of coal, oils, rice, salt and timber are carried in the coastal trade of India. The passenger traffic is also considerable; over a million and a half are carried along the west coast of India. The tragedy is that this traffic is not in Indian hands. There are three British companies engaged in the coastal trade of India. . . . They practically monopolize the trade, as their share is about 80 per cent.'—J. E. Castellino's article on 'Planning in Transport' in *The Eastern Economist*, 3 December 1943.

These figures show that Bombay, Calcutta and Rangoon (before the separation of Burma) to a very large extent, and Karachi and Madras to a smaller extent, accounted for the bulk of the total foreign and coastal trade of India.[1]

Total Trade of Eight Principal Ports (in lakhs of rupees)

	1909-14 (Pre-war average)	1914-18 (War average)	1937-8	1938-9	1939-40
Bombay					
Foreign	113,15	121,34	113,13	95,92	107,73
Coasting	32,30	37,03	37,02	35,19	30,50
Total	145,45	158,37	150,15	131,11	138,23
Calcutta					
Foreign	141,06	145,10	129,03	120,25	157,69
Coasting	18,72	17,40	13,89	14,01	11,52
Total	159,73	162,50	142,92	134,26	169,21
Rangoon					
Foreign	29,93	35,59	..	..	..
Coasting	19,03	25,27	..	..	..
Total	48,96	60,86	..	..	..
Karachi					
Foreign	38,87	35,59	43,48	34,59	35,24
Coasting	9,00	11,29	18,36	16,07	17,48
Total	47,87	46,88	61,84	50,66	52,72
Madras					
Foreign	16,80	17,78	30,63	26,41	29,49
Coasting	2,81	3,37	3,41	3,22	3,04
Total	19,61	21,15	34,04	29,63	32,53
Cochin					
Foreign	2,72	2,82	11,11	10,04	12,76
Coasting	3,56	2,78	4,21	4,21	3,19
Total	6,28	5,60	15,32	14,25	15,95
Tuticorin					
Foreign	5,56	5,72	5,37	4,14	5,58
Coasting	1,67	1,83	4,67	3,52	3,97
Total	7,23	7,55	10,04	7,66	9,55
Chittagong					
Foreign	5,71	3,79	9,66	10,04	12,30
Coasting	1,76	3,14	74	32	26
Total	7,47	6,93	10,40	10,36	12,56

To ensure the fullest possible development of the coastal trade in India, a comprehensive programme of port development, the building up of an Indian mercantile marine and a proper co-ordination between coastal and railway traffic are necessary, but these are topics on which we have already expatiated at considerable length.[2]

§34. (ii) **Inland trade.**—India, like America, but unlike the United Kingdom, is more vitally interested in her internal than in her external trade. This is not surprising in view of the continental dimensions of the country, her teeming population, her diversity of physical and climatic conditions and her vast and

[1] For an interesting account of the trade of the principal ports see Vera Anstey, *Trade of the Indian Ocean*, pp. 79-85.

[2] See ch. v.

varied natural resources. In modern times the extension of improved means of communication and transport has added greatly to the volume of the internal trade, and this process will be quickened by a general economic advance and the progress of organization, which will increase the scope for exchange between town and country.

The great importance of the internal trade of India is insufficiently appreciated. The imposing figures of the exports of cotton, jute, rice, wheat, oil-seeds, etc., represent only a moderate proportion of India's total production, of which some idea has already been given; though of course it is true that not all that remains after export is offered for sale, for a part is directly consumed by the producers, as in the case of the peasant proprietors who consume a large portion of the foodstuffs raised by them. The great importance to India of her internal trade is brought out by the consideration that 'if India's total agricultural produce is taken into account, calculations show that for every acre of land producing goods, whether grain, oil-seeds, fibres, tea, etc. for export, eleven acres are cultivated for local consumption'.[1] To the agricultural production which remains in the country for internal consumption and exchange must be added the non-agricultural produce, such as mineral production and manufactures, of which only a small percentage is exported abroad.

No accurate and reliable statistics are available regarding the volume and the value of the inland trade of the country. Fairly satisfactory data are available regarding the coastal trade, the bulk of which, as said above, may be regarded as part of the internal or the inter-provincial trade of the country. But so far as the inland trade proper goes, scarcely any information beyond the statistics of the goods traffic of railways was available for some years. Until 1923 the Department of Statistics used to publish the compilation *Inland Trade (Rail and River-borne) of India* annually, and all the provinces issued similar publications. These gave the import and export trade in staple articles of each of the five or six blocks into which every province was divided; and the imports and exports of eighteen bigger blocks forming the trade divisions of India as a whole. The figures related to quantity only; the figures of value, given in a few cases, were admittedly very rough. The internal trade returns were defective in other respects also. Trade within a block was not recorded; there was obvious evasion on railways; and trade by road, which is not negligible, was not taken into account.[2] However in spite of their defects these statistics were of some utility, and it was unfortunate that, except in one or two provinces, they were discontinued, as was also the publication *Inland Trade (Rail and River-borne)* in 1923 on the recommendation of the Retrenchment Committee. The Economic Inquiry Committee rightly pressed for the revival of the publication of the internal trade returns, and for their improvement so as to bring them into line with the more up-to-date statistics of the same kind maintained by countries like the United States. The Government of India have revived the publication of these statistics since April 1933, by issuing *Accounts relating to the Inland (Rail and River-borne) Trade of India*, every month, offering a summary view of the inland trade of India during each month together with running totals

[1] See *The Economic Resources of the British Empire* (ed. W. Worswick), p. 145.
[2] *Economic Inquiry Committee Report*, p. 13.

from the beginning of the official year. The new series, which is published by the Ministry of Commerce, retains in essentials the form of the older publication. The statistics are given relating to the inland trade of India carried by the railways and the steamer services, and represent the movement of trade into and from a province, taken as a whole, or a chief port or ports, the trade of which is registered separately from that of the trade of the province in which such port or ports may be situated. The trade dealt with in these accounts falls into one or other of the following categories: (*a*) the trade of a province with other provinces, (*b*) the trade of a chief port with the province in which it is situated, and (*c*) the trade of a chief port with other provinces. Goods carried from one station to another within the same province or principal trade block are not registered for the purpose of these accounts. For the purpose of registration of these statistics the country was divided into 18 principal blocks as follows: (*a*) 9 blocks representing 'British' provinces, (*b*) 4 representing the principal port towns, viz. Calcutta, Bombay, Madras and

TABLE I

(*In thousand maunds*)

	1937-8	1938-9	1939-40	1940-1	1941-2	1942-3	1943-4
Coal and coke[1] ..	464,286	449,854	496,513	..	..	..	..
Cotton, raw ..	19,185	19,538	20,712	20,914	20,607	17,775	15,358
Cotton piece-goods	11,190	11,077	11,294	12,771	11,444	10,351	11,004
Grain, pulse and flour ..	131,900	131,272	143,356	130,187	135,004	104,731	107,405
Hides and skins, raw[1] ..	2,970	2,679	3,383	..	..	..	..
Jute, raw ..	32,574	31,497	32,767	28,074	25,954	18,145	16,590
Gunny bags and cloth ..	5,336	5,218	5,484	5,859	7,011	12,886	8,456
Iron and steel bars, sheets, girders and other commercial forms of iron[1] ..	38,655	41,894	41,986	..	..	..	..
Oil-seeds ..	39,646	50,063	43,775	39,369	43,544	36,141	30,471
Sugar (including gur, rab, etc.) ..	39,485	38,076	28,949	38,866	39,080	11,691	30,007
Total ..	785,227 (125)	781,168 (124)	828,219 (132)	.. ..	.. ..	.. ..	.. ..

Karachi, and (*c*) 5 representing Indian States. The statistics relate to quantities and denominations only, and figures of value are not given.[2] The net weights are given uniformly in standard maunds of $82\frac{2}{7}$ lb. The statistics of the new series have the same defects as those of the older one.

Table I above shows the quantity of inland trade in certain important articles from 1937 to 1944.

[1] Later figures are not available as they have been excluded from the table in *The Review of the Trade of India*, 1943-4.

[2] See *Accounts relating to the Inland (Rail and River-borne) Trade of India*, for March 1940, pp. 1-3. Owing to the great disparity between the prices for the same commodity in different parts of the country, it is not possible to work out the corresponding figures of value.

The above table shows that the quantity of inland trade recorded a considerable increase in volume during the year 1939-40. All commodities for which figures are recorded shared in this increase, except oil-seeds and sugar. On the whole, the internal trade activity was distinctly better during the year 1939-40 than at any time in the preceding six years.

The condition of internal trade can also be judged to some extent by the statistics of railway earnings and traffic published by the Railway Board. Table II below shows these figures from 1928-9.

TABLE II

Gross earnings and total wagons loaded from 1928-9 *to* 1943-4

Year	Gross Earnings State-owned Railways (excluding Burma Railways)	Total wagons loaded[1]
	(*Rs. crores*)	(*000*)
1928-9	99·61	6,993
1929-30	97·53	6,898
1930-1	90·40	6,632
1931-2	82·54	6,098
1932-3	82·11	5,996
1933-4	84·64	6,489
1934-5	87·24	6,850
1935-6	88·36	6,962
1936-7	92·04	6,900
1937-8	94·85	7,161
1938-9	94·36	7,225
1939-40	98·44	7,509
1940-1	112·16	7,589
1941-2[2]	129·37	7,499
1942-3	156·46	6,553
1943-4	185·49	6,910

The gross earnings of State Railways during 1939-40 exceeded the total for the previous year by Rs. 4 crores and were higher than in any year since 1928-9. The tendency towards improvement in railway traffic became even stronger in subsequent years, mainly because of increased internal trade activity following the outbreak of the war.

In the absence of full and dependable statistics relating to inland trade, no precise idea can be formed of its dimensions and of its relative importance as compared to the foreign trade of the country. According to *Inland Trade of India*

[1] These include Burma Railway figures up to 1935-6.

[2] While there was a large increase in the number of wagons loaded in 1939-40 as compared with the preceding year, the increase in 1940-1 was practically negligible and from 1941-2 there was an actual decrease. This apparent decline cannot be attributed to any falling off in the economic activity of the country, but is due to the fact that a large number of wagons loaded on special trains for military traffic are not included in these figures for the war years. Further, owing to relatively greater efficiency in working, it was possible for the railways to carry a larger amount of merchandise per wagon on the average than in the past. The total tonnage of goods traffic in 1941-2 increased by over 5¼ millions and the total net ton mileage increased by nearly 2¾ millions, as compared to 1940-1, indicating a substantial increase of inland trade. See *Review of Trade*, 1941-2, pp. 99-100.

for 1920-1, the total inland trade was estimated at nearly Rs. 1,500 crores, thus giving a proportion of $2\frac{1}{2}:1$ between the domestic trade and the foreign trade.[1] Such figures as are available, however, leave no doubt regarding the small volume of the inland trade in relation to the size and the population of the country. With a fuller development of the economic resources of the country the volume of internal trade is bound to increase to many times its present size. It is also necessary to follow a policy of systematic development of the inland trade of the country having regard to the uncertain character of the external trade. The revival of our external trade will, of course, stimulate the internal trade. It is, however, desirable to bring about its extension apart from its connexion with the external trade.

§35. **Principal trade centres of India.**[2]—We may now fittingly conclude this chapter with a brief description of the principal trade centres of India, and follow it by a few words about commercial intelligence and trade organizations. In an account of the trade centres of India mention may first be made of the four principal harbours of the Indian sub-continent, namely, Calcutta, Bombay, Karachi, and Madras. Calcutta and Bombay are not only the principal ports but also the most important industrial centres of India. Bombay is further the chief distributing centre for western India for the large volume of imports of cotton manufactures. Bombay's trade is mainly in Indian hands as against Calcutta's which is largely controlled by Europeans. Karachi, now in Pakistan, was the centre of the wheat trade. Madras also is a considerable trade and industrial centre but not comparable in importance to Bombay or to Calcutta. Apart from these four principal ports,[3] other big trade centres are Cawnpore, Delhi, Ahmedabad, Amritsar, Agra, Lahore, Benares, Lucknow and Nagpur. Cawnpore, which is an important railway junction in the United Provinces, holds a central position, being situated half-way between Bombay and Calcutta, and is a convenient distributing centre for foreign and local goods. Delhi, now the capital of India, is the junction of nine railway lines and an important clearing house for the Punjab and the western districts of the United Provinces, particularly in cotton, silk and woollen piece-goods. Ahmedabad is, next to Bombay, the most important centre in the Bombay province. Amritsar in the Punjab has not only a large entrepôt trade in piece-goods, but also does a large business in skins and hides; it is also well known for its carpet industry. Agra has considerable manufacturing industries connected with carpets, durries, embroideries and stone work, and is a collecting centre for the better qualities of hides. Lahore is the chief trading centre for the agricultural produce of the Punjab. Benares is mainly of interest as a considerable centre of the silk-weaving industry. Lucknow is commercially of interest as a distributing and collecting centre for the rich agricultural produce of Oudh. Nagpur derives its commercial importance from its weaving mills,

[1] K. T. Shah holds that this is an underestimate, and places the value of the inland trade of India at Rs. 2,500 crores. *Trade, Tariffs and Transport*, p. 122.

[2] See C. W. E. Cotton, *Handbook of Commercial Information for India* (third edition), pp. 62-113; also vol. I, ch. ii. This account of trade centres applies to the Indian sub-continent as a whole, including Pakistan as well as the Indian Union.

[3] Besides these principal ports others of some importance are Cochin, Goa, Chittagong and Vizagapatam; and in Kathiawar: Bedi, Okha, Porbunder and Bhavnagar.

cotton-ginning and pressing factories, and the extensive manganese deposits in its neighbourhood. In addition to these centres of trade, mention may be made of Jubbulpore, Mirzapur, Madura, Gwalior, Dacca, Srinagar, Sholapur, Amraoti, Hyderabad (Deccan), Allahabad, Jaipur, Baroda, Bangalore and Mysore.

§36. **Commercial intelligence and trade organization.**[1]—The collection, careful analysis and judicious distribution of commercial and industrial intelligence has now come to be a necessary function of governments in civilized countries in view of the international competition in industry and commerce. Not a little of the prosperity of countries like Germany, Japan and the United States was due to their excellent system of commercial intelligence. Trade commissioners are appointed and consuls stationed in foreign countries, their main duty being to supply information about foreign markets to their respective countries. India is insufficiently equipped in all these respects. Though the Commercial Intelligence Department came into existence as far back as 1905, there was no clearly defined channel through which information on commercial matters in the possession of the Government could be communicated, either publicly or to individual applicants.[2] The position today is somewhat more satisfactory than it was a few years ago. The Department of Commercial Intelligence and Statistics, which was reorganized in 1922, now forms a connecting link between the commercial public and the Government of India. It embraces two distinct classes of work: (i) collection and dissemination of information bearing on overseas trade which may be of use to Indian firms and (ii) the compilation and publication of statistics of all-India importance relating to trade, industry and so on. The Department[3] answers trade inquiries, effects trade introductions and publishes in the *Indian Trade Journal* (the weekly organ of the Department) statistics and other information of commercial value. It keeps in touch with trade developments of interest to India in the United Kingdom, and in many other countries, through the medium of the various Indian Trade Commissioners. Opportunities for commercial publicity are utilized as they present themselves. This step has led to some useful results. The Department of Commercial Intelligence and Statistics also works in close co-operation with the Directors of Industries and other Government Departments in India, with the Indian Trade Commissioners in London and other centres (see below), with His Majesty's Trade Commissioners in India and the Dominions and with Consular Officers in various parts of the world in order to stimulate the overseas demand for Indian produce and manufactures. The High Commissioner for India in London, whose office was created in 1920, has been saddled with much miscellaneous agency and financial work, of which the purchase of Government stores is the most important. He is therefore not in a position to be of much use for promoting Indian commercial interests abroad.

The organization described above is chiefly concerned with making known

[1] §§36-7 should be read with §§11-12.

[2] *Industrial Commission Report*, par. 180.

[3] A Central Statistical Research Bureau for the continuous analysis and interpretation of economic and statistical facts and phenomena was established in 1933 under the Director-General of Commercial Intelligence and Statistics. It is now placed in charge of the Economic Adviser to the Government of India appointed in 1937.

abroad information regarding the possibilities of Indian markets for foreign goods. It is equally necessary, however, to supplement it by a similar organization for the purpose of making available in India information regarding foreign markets for Indian goods. New ground was broken in this direction by the Trade Mission which was deputed in 1928 by the Government of India in pursuance of a suggestion made by the Textile Tariff Board (1926) to explore the potentialities of certain export markets for Indian textile goods.[1] The Report submitted by the Trade Mission suggested the appointment of three Trade Commissioners for India to be stationed at Alexandria, Mombasa and Durban. The establishment of Indian trade agencies and of an independent Indian consular service, as in the case of other Dominions, has since taken place. Indian Trade Commissioners have so far been appointed in the U.K. and Eire; Australia and New Zealand; Canada and Newfoundland; East Africa; Egypt; Ceylon; Pakistan; Eastern Pakistan; Brazil; Iran; France; Germany; Japan; Burma; and Afghanistan. It is expected that Commercial Representatives will soon be appointed in Italy, Iraq, Aden, Czechoslovakia, West Canada, Fiji and Switzerland.

In this connexion we may refer to the emphasis placed by the Meek-Gregory Report on the importance of better salesmanship in canvassing Indian goods abroad.[2] Two useful suggestions were made at their session in March 1941 by the Federation of Indian Chambers of Commerce and Industry: first, that the Government of India should organize trade missions consisting of Indian business men with the necessary technical staff to visit the various parts of the British Commonwealth and neighbouring countries with a view to studying the conditions of their import trade; and secondly that they should constitute a comprehensive export organization for the supervision and control of the quality and specifications of Indian exports, the necessary funds for financing its activities being raised by means of a small export cess.

§37. **Commercial organization in India.**—The most important and the best organized non-official commercial organizations in India are those formed by European merchants, such as the Associated Chambers of Commerce of India and the various Chambers of Commerce at Calcutta (1834), Bombay (1836), Madras (1836), Cawnpore and other principal centres. Their membership, except in Bombay, was till recently preponderantly European, though open to Indians also. This was but the natural outcome of the earlier start made by European traders in establishing commercial connexions between India and the West. In addition to the Chambers of Commerce there are also associations representing particular branches of trade, such as jute mills and cotton mills; and also those representing wholesale traders in the principal cities. Hitherto the Indian commercial community have suffered from lack of suitable organizations for obtaining redress for their legitimate grievances, but Indian merchants are waking up to the necessity of organizing themselves. There are now several purely Indian associations, such as the Bengal National Chamber of Commerce which is the oldest (1887) organization of the Indian mercantile community, the Indian Merchants' Chamber and Bureau, Bombay (1907), the Southern India Chamber

[1] See *ante*, p. 27, and *India in* 1928-9, p. 198.

[2] *Report on Prospects of Indian Trade with the United States of America*, par. 67.

of Commerce, Madras (1909), the Indian Chamber of Commerce, Lahore (1912), the Indian Chamber of Commerce, Calcutta (1925), the Maharashtra Chamber of Commerce, Bombay (1927), and the Merchants' Chamber of the United Provinces (1932). There is also an All-India Federation of Indian Chambers of Commerce and Industry.[1] All these organizations can be of immense service in focusing commercial opinion in India and giving a lead to the Government in regard to problems affecting the commercial and industrial development of the country.

[1] For an account of the several Chambers of Commerce and Commercial Associations in India, see Cotton, op. cit., part iv.

CHAPTER VII

TRADE AGREEMENTS

§1. **Imperial preference: History of the movement.**—The movement towards Empire trade consolidation may be said to have made a start in 1897, when Canada lowered her duties by one-eighth in favour of British goods. In 1898, the preference, fixed at one-fourth of the duty, was given to the United Kingdom unconditionally, but so far as the other Colonies were concerned, it was made conditional on favourable treatment granted by them to Canada. The Colonial Conference which met in 1902 adumbrated the policy of imperial preference as one of general application to all parts of the Empire, which were invited to fall into line with Canada. Accordingly, preferential duties in favour of Great Britain were introduced by New Zealand and South Africa (1903) and later by Australia (1907), and the United Kingdom was expected to reciprocate and grant preferences in return. England, however, was not then prepared to depart from her free trade policy. She mostly imported raw materials and food-stuffs, and her attitude was that her interests as a great exporter of manufactured articles demanded that she should obtain the food-stuffs and raw materials in the cheapest market. Especially in the matter of food-stuffs she was not prepared 'to put all her eggs into one imperial basket'. In the circumstances, the United Kingdom was unable to take any part in the general movement for imperial preference. The self-governing Colonies, however, continued the policy they had begun, hoping that the mother country would find ways of joining in at some future date. Since 1920 the Dominions and Colonies have given extensive preferences to the United Kingdom, and by 1922 preferential tariffs were in operation in twenty-six British Colonies. Their tariffs thus came to consist of (i) revenue duties, (ii) protective duties and (iii) certain remissions of duty in respect of (i) and (ii) in favour of the United Kingdom and in some cases also in favour of India and other Empire countries. There was also a limited free list of commodities taxed only when they came from outside the Empire. As a general rule preferences granted by the Dominions have primarily sought to benefit the United Kingdom, and they have been left to be extended to other parts of the Empire by special negotiations in each case. The approaches which England had made since 1915 towards protection enabled her to grant preferential reduction of duties on a limited number of articles of Empire origin. Great Britain's formal renunciation of free trade in favour of a protectionist regime with the enactment of the Import Duties Act in March 1932 was an event of first-rate importance from the point of view of imperial preference.

§2. **Indian attitude towards imperial preference.**—India's reluctance to participate in any project of imperial preference is partly to be explained in terms of politics. She was naturally unable to share the enthusiasm of the Dominions in the underlying idea of imperial preference which is to increase the strength and solidarity of the Empire—an Empire, membership of which spelt political bondage for her and failed to prevent racial discrimination and injustice for her nationals in other parts of the Commonwealth.

Economically also imperial preference has not seemed to offer any advantages to India in view of the following considerations:

(i) India's imports consist largely of manufactured articles and her exports of raw materials and food-stuffs. (ii) In the period before the war of 1914-18 about two-thirds of her total imports came from the British Empire, the United Kingdom contributing by far the largest share to the imports from the British Empire. (iii) Before the war of 1914-18 Indian exports went preponderantly to foreign countries, only about forty per cent of the total exports being absorbed by the British Empire. The exports to the United Kingdom amounted to about one-fourth of the total exports. (iv) After World War I, there has been a tendency towards a gradual relative decline of the importance of the United Kingdom and the other Commonwealth countries in the trade of India as regards both exports and imports, but specially as regards imports.

In 1903 the Government of India expressed the view 'that from an economic standpoint India has something, but not perhaps very much, to offer to the Empire, that she has very little to gain in return, and that she has a great deal to lose or to risk'.[1] They feared that preference shown by India to Empire countries would be met by retaliatory measures against her on the part of foreign countries. Her foreign markets are much too important for India to be lost or endangered through any ill-judged policy of imperial preference.

§3. **The Ottawa Agreement.**—At the Imperial Economic Conference held at Ottawa in July and August, 1932, a series of Trade Agreements were concluded among the countries of the Empire on the basis of reciprocal exchange of preferences, and India found herself participating in just such a scheme of extensive imperial preferences to which she had all along shown a strong antipathy. The Indian Tariff (Ottawa Trade Agreement) Amendment Act of 1932 (December) gave effect to the tariff changes necessitated by the general trade agreement made between the Government of India and His Majesty's Government in the United Kingdom on 20 August 1932.[2] The tariff changes so effected came into force from 1 January 1933. A supplementary agreement regarding iron and steel was signed on 22 September 1933.

§4. **The case for Ottawa.**—The first phase of the economic crisis which started in 1929 was characterized by a great decline in all prices, but a relatively heavier decline in the prices of raw materials. In consequence of this, India, along with other suppliers of raw materials, was particularly badly hit. In addition to this, her export trade was being subjected to growing competition in Western markets. Virgin lands in many parts of the world—in Africa, South America, the Asiatic Archipelago, etc.—were being brought under cultivation, and their products began to be introduced to the world markets all the more easily because of the improved transport facilities.

In other countries also production was expanding, and foreign exporters

[1] This view was repeated by India's representatives at the Imperial Economic Conference of 1923.

[2] See ch. xii, §4. What were virtually preferential duties in favour of the United Kingdom were incorporated in the scheme of protection granted to the Indian steel and iron and textile industries. See ch. ii, §§11 and 25.

who before the war of 1914-18 were comparatively insignificant were now proving serious competitors: the force of the increased competition was keenly felt by some of our main exports like oil-seeds, textile fibres, food-grains, timber, etc. The position was further made difficult by the policy adopted by many of the European countries and the United States of America of stimulating the demand for the products of their own colonies in the tropical and sub-tropical regions. Another factor was the rapid development of synthetic substitutes, which tended to reduce the demand for some of India's staples of export. Many countries, again, had embarked on a policy of economic isolationism which led to the erection of higher tariff walls, the imposition of 'contingents' and quotas, the institution of stringent foreign exchange controls and other restrictions on the free flow of international trade.

In the meanwhile (September 1931) Great Britain had abandoned the gold standard, and the currencies of India and of most of the other Empire countries were linked to sterling. By the Import Duties Act of 1932, referred to above, duties had been imposed in Great Britain on a wide range of articles covering nearly two-thirds of the total imports. Provision was, however, made for the exemption of Empire products from these duties, pending negotiations with the Dominions and India for the conclusion of reciprocal tariff arrangements—negotiations which eventually issued in the Ottawa Agreement. In the opinion of its advocates, it was a wise step on the part of India to have entered into the Agreement, for failure to do so would have meant forfeiture of her access to the world's most stable and largest open market, namely the United Kingdom. As explained above, the normal outlets for India's exports were shrinking fast. Other countries like France and Germany were still struggling with currency difficulties. The countries belonging to the sterling group were on the other hand comparatively free from these difficulties, and trade with them was for that reason likely to be smooth and unhampered by exchange embarrassments.

Between 1932-3 and 1933-4 India's export trade to the United Kingdom increased by 28·2 per cent, while her trade with other countries advanced by only 4 per cent. The increased demand for raw materials was no doubt partly responsible for this improvement. Further, the import trade figures of the United Kingdom for 1932 and 1933 showed an increase in imports from India more than proportionate to the increase in the total imports of raw materials, pointing to the conclusion that the preferences must have contributed largely to the expansion in India's exports in 1933-4.

The *total* imports coming from all sources of the articles on the preferential list into the United Kingdom fell by about 22 per cent between 1931 and 1934. The imports from India however increased in a market which was on the whole contracting, and therefore it was legitimate to infer that the special factor of imperial preference must have helped. The greater expansion in the non-preferential group was not surprising, because this group comprised articles which had not to face any serious competition abroad and were for that reason not included in the preferential list. Again, in the case of some of the important items in the non-preferential group, there were certain quite specially favourable influences (apart from industrial revival) accounting for the increase in their off-take. Thus the increase

in the demand for cotton was largely due to the propaganda of the Lancashire Indian Cotton Committee. The increase in rubber was due to the restriction scheme; that in metals and ores to the renewed activity in the heavy industries (as distinguished from *general* industrial revival); that in lac, to speculative purchases by the London 'ring', which tried to operate a corner in shellac and pepper, and so on.

The contention of the critics of the Agreement that the increased exports to the United Kingdom represented merely a diversion of trade was met by pointing out that while the increase of exports to the United Kingdom could fairly be attributed to the Ottawa preferences, the decline in the exports to foreign countries was due to the policy of self-sufficiency followed by these countries for reasons entirely unconnected with Ottawa. In fact, it was precisely this policy of restriction and the consequent loss of trade from which both India and England suffered, which formed the principal justification for Ottawa. It was no doubt true that India had hitherto been able to sell about two-thirds of her exports to countries outside the British Empire. But that she was finding it more and more difficult to retain her hold on these foreign markets was not her fault. The system of preferences was a measure of self-defence adopted by India. Some of its consequences, e.g. a decline in India's import trade with foreign countries followed by a corresponding diminution of her exports to them, were no doubt deplorable. But they were not of India's seeking and were in the circumstances inevitable. One of the arguments against the Ottawa Pact was that it would lead to retaliation against India by her foreign customers. But the various restrictions on import trade imposed by foreign countries were universal in character and not specially discriminatory against India. They were inspired by certain new ideals of trade policy, and there is no evidence to show that they were the result of irritation due to the Ottawa Agreement.

§5. The case against Ottawa.—Those who opposed the Ottawa Pact did so mainly on the ground that it tended to deflect India's trade from its natural channels and to give it a deliberate twist so as to inflict serious damage on it. If the preferences decreased competition in the United Kingdom, they made it more severe in the other far more important foreign markets. An examination of the principal items of preference seemed to prove that only a few articles such as linseed, carpets, rugs and rice had derived any positive benefit from the preference. Since the separation of Burma from India in 1937, some of the important commodities which enjoyed preference under the Ottawa Agreement (viz. rice, teakwood, pig-lead, and paraffin wax), either dropped out or were considerably reduced in importance in the possible scope of any fresh agreement with the United Kingdom.[1] In most other cases the vindication of the Ottawa arrangements was found to be either insufficient or wholly wanting. For some articles the preference granted was really not needed. For example, the tea trade was taking good care of itself through the Tea Restriction Scheme by which the main producers of tea, namely India, Ceylon and Java, had already come to an agreement amongst themselves. Preference, again, was unnecessary where the commodity in question already domi-

[1] Article by B. K. Madan, 'Bilateralism and Indian Trade', *Indian Journal of Economics*, July 1938. See also §9 below.

nated the market in the United Kingdom, as in the case of jute manufactures, goat-skins, castor-seeds, lac, myrobalans and mica. In other cases the possibility of further expansion was slight for a variety of other reasons such as (i) the presence of other Empire competitors, e.g. Australia in tanned sheep-skins; British West Africa in groundnuts; Australia and Canada in pig-lead; Ceylon in coir-mats and spices; British East Africa in coffee. In some cases, the United Kingdom market was very small as compared to foreign markets, e.g. in groundnuts. Again, as regards certain articles, the total exports from India were too insignificant to make it worthwhile encouraging trade in them either by preference or otherwise, e.g. in rice, barley and tobacco.[1] Sometimes, the Indian commodity was not of the type wanted in the United Kingdom and hence could not benefit from the preference, e.g. Indian tobacco. Lastly, the effects of the preference might be largely cancelled by the competition of substitutes, as in the case of oil-seeds.

Another objection was that the preferences either caused a loss of revenue to the Government (i.e. in so far as trade was diverted from the higher to the lower duty) or to the consumer (i.e. in so far as the consumer was compelled to buy comparatively expensive goods instead of cheaper non-British goods). Neither the Government nor the consumer in India was in a position to afford this sacrifice.

Imperial preference might suit Colonies and Dominions whose trade with the United Kingdom was of a complementary character. England desired the primary products which the Dominions, especially Australia and Canada, had to offer, and they were able and willing to absorb a great many British manufactures. In both respects India's position was different. It was more advantageous and more feasible for her to find markets for her products elsewhere than in the United Kingdom, and her varied natural resources made it possible for her to think of self-sufficiency as the goal of her ambition, in fulfilment of which she desired protection against the competition of a number of British manufactured goods at that time imported into India.

The recent trend of India's foreign trade had been away from the Empire[2] and it was most important that she should make a systematic and determined endeavour to retain the foreign markets which absorbed the greater part of her exports. The only practical method of achieving this was by entering into a series of bilateral agreements with foreign countries.[3] Ottawa (replaced by the Indo-British Trade Agreement in 1939), however, sadly reduced India's capacity for bargaining by tying her hands in respect of far too large a number of commodities, so that she found she had hardly anything to offer to foreign countries in return for any concessions she sought from them. It was not likely that these bilateral agreements with other countries would seriously affect India's exports to the United Kingdom, most of the exports to the United Kingdom being raw materials which British industry was interested in admitting free of duty. Moreover, so long as England was our main creditor, and payment could only be effected through our surplus of exports over imports, England had either to take the necessary measures to enable us to retain our foreign markets or open her own market to us to make up

[1] Sir Bryce Burt, however, called the tobacco trade 'the valuable trade of £9,000,000' in an Assembly debate.

[2] See ch. vi, §18.

[3] See §16 below.

for the shrinking of our foreign markets. Otherwise India could not meet her obligations in England. The drift of the argument was that there was no need to fear retaliation on the part of the United Kingdom even if we had refused to participate in inter-Imperial arrangements on the Ottawa model. Also retaliation on the part of England would have endangered her own considerable exports to India—worth more than Rs. 50 crores per year during the pre-(1939)-war period.

Much capital was made by the supporters of the Ottawa Agreement out of the reversal of the balance of trade in recent years between India and the United Kingdom. Until 1935-6, India used to have a negative balance of trade with the United Kingdom in spite of the fact that this country had to make large payments to England on account of 'invisible' imports such as the Home Charges, shipping freights, profits on foreign capital invested in India, etc. Since 1936-7 there had been a substantial export surplus in India's favour. It was therefore suggested that India should accord generous treatment to the United Kingdom in any future trade arrangements. However, so far as it was proper to consider the trade balance on the narrow basis of bilateralism, it was necessary to add to the imports of merchandise from the United Kingdom, our 'invisible' imports from that country. This was all the more necessary since owing to the decline in triangular and multiangular trade, especially with European countries, we had to have a larger export balance in merchandise with the United Kingdom. To some extent the operation of the Ottawa Agreement itself was responsible for this result, which therefore did not constitute a justification for liberal concessions to the United Kingdom. Further, since a good portion of our exports to the United Kingdom was the product of British capital and enterprise in this country, the loss which might result from any restrictive action by the United Kingdom against India would have adversely reacted on Great Britain herself.[1]

An important cause of dissatisfaction with Ottawa was the feeling that the Indian Delegation (which did not include any responsible representatives of Indian commerce, industry and agriculture) failed to make full use of India's bargaining strength vis-à-vis Great Britain and gave away too much and received too little in return. The agreement was too hastily devised and enforced and was not based on any thorough inquiry by a competent body such as the Tariff Board, which should have applied tests similar to those applied in the policy of discriminate protection before recommending any Empire industry for preferential treatment in India.

Before turning to the adverse verdict of the Assembly on the Ottawa Agreement and its sequel, we shall pass under review the Bombay-Lancashire Textile Agreement (1933) and the Supplementary Indo-British Agreement (1935).

§6. **The Bombay-Lancashire Textile Agreement (Mody-Lees Pact).—** At about the time (1933) the negotiations for the Indo-Japanese Trade Agreement were in progress, following the conference between the representatives of the Indian and British cotton textile industries in Bombay in September 1933, an understanding was reached to which the respective parties were the Millowners' Association, Bombay, then presided over by Sir Homi Mody, and the British

[1] See article by Dr V. K. R. V. Rao, 'The Indo-British Trade Agreement', *Indian Textile Journal* (April 1937).

Textile Mission to India led by Sir William Clare Lees. This agreement, which is popularly called the Mody-Lees Pact, was to remain in force till 31 December 1935. There were sharp differences among the representatives of the Indian textile industry, and the attempt to secure a common front failed. It was, however, found possible for Lancashire to conclude an agreement with the Millowners' Association, Bombay. 'The Agreement—a precursor of the general understanding embodied in the supplementary Indo-British Agreement [see § 7 below]—reiterated the right of India to protect the Indian industry even against the United Kingdom but recognized that a higher level of protection was needed against other countries than the United Kingdom.'[1]

It provided for the stabilization of the position in regard to the tariff on imports of United Kingdom piece-goods into India when the revenue position of the country made it possible for the Government of India to remove the general surcharge on all imports imposed in October 1931. A lower scale of duties on cotton yarns and artificial silk piece-goods imported into India from Lancashire was agreed to on the Indian side. This was incorporated in the Indian Tariff (Textile Protection) Amendment Act, 1924. In so far as the Empire and other overseas markets were concerned, it was agreed that any advantages which might be arranged for British goods should be extended to Indian goods, and that India should participate in any quota which might be allocated to the United Kingdom in markets in which India had no independent quota. In regard to raw cotton, an undertaking was given that the British Textile Mission would be prepared to recommend effective action being taken to popularize the use of the Indian raw material in the interests of the Indian cotton grower.

The Bombay-Lancashire Agreement was the first attempt to achieve by agreement the co-ordination of Indian and British interests, by what may be called imperial industrial co-operation. In the judgement of some people, the Agreement abundantly justified itself. It brought about a very considerable increase in the off-take of Indian cotton by Lancashire (thanks to the efforts of the Lancashire Cotton Committee) and thus conferred much benefit on the Indian agriculturist. Lancashire had also frankly recognized the need for adequate protection to the Indian textile industry as against itself, and offered its good offices to promote the interests of the Indian textile industry in overseas and colonial markets.

On the other hand, the critics of the Agreement argued that it had not the support of the whole Indian textile industry and that, while India had conferred substantial and definite benefits (i.e. reductions in duties on cotton and artificial silk piece-goods) on Lancashire, the latter merely made certain promises without any definite commitments. The agreement meant the withdrawal of much of the protection previously enjoyed by the Indian industry. As to overseas markets, since the Bombay mills were unable to stand unaided even in the home market, they could hardly be expected to make much headway in the overseas markets even with the help and goodwill of Lancashire. Lastly, as regards the use of Indian cotton by Lancashire mills, the Agreement merely held out a vague promise and did not require Lancashire to buy a minimum quantity of Indian cotton as in the case of Japan.

[1] B. K. Madan, *India and Imperial Preference*, p. 162.

§7. **The Supplementary Indo-British Trade Agreement (1935).**—The Bombay-Lancashire Agreement (1933) was followed up by the Indo-British Trade Agreement in 1934 (actually signed on 9 January 1935). This Agreement, as already stated, was supplementary to the Ottawa Trade Agreement (1932) and was to be in force during the currency of the latter Agreement.

The Government of India undertook to afford protection only to such industries as after due inquiry by the Tariff Board had established claims thereto in accordance with the policy of discriminate protection. The measure of protection to be afforded was not to exceed what was necessary to equate prices of imported goods to fair selling prices for similar goods produced in India, and subject to this condition, lower rates of duty whenever possible were to be imposed on goods of United Kingdom origin. The Government of India agreed to afford full opportunity to any industry concerned in the United Kingdom to state its case and answer cases presented by other interested parties before the Indian Tariff Board when the question of grant of protection to an industry was referred to that body. The Government of India further undertook that in the event of any radical change in the conditions affecting protected industries during the currency of the period of protection, they would on the request of His Majesty's Government, or of their own motion, cause an inquiry to be made as to the appropriateness of existing duties, and that in such an inquiry full consideration would be given to any representation put forward by any interested industry in the United Kingdom.

The United Kingdom Government on their side promised to consider steps that might be taken to develop the import from India of raw or semi-manufactured materials used in the manufacture of articles subject to differential import duties in India. They also undertook to take further steps to stimulate the use of Indian cotton (in pursuance of Article 8 of the Ottawa Agreement and the Mody-Lees Pact) in all possible ways, including research, commercial investigation, market liaison, and industrial propaganda. They undertook to continue the privilege of duty-free entry of Indian pig-iron into the United Kingdom so long as the duties on articles of iron and steel imported from the United Kingdom into India were not less favourable than those provided for in the Iron and Steel Protection Act, 1934.

The supporters of the Agreement maintained that it 'implemented implied promises given at Ottawa and the definite promises given to the Clare Lees Deputation'. The Agreement conferred on India material benefits regarding the increased consumption of Indian cotton and of raw and semi-raw materials, and the privilege of duty-free entry of Indian pig-iron into the United Kingdom. India was also promised a share in such facilities as might be granted to British cotton goods by the Colonies and Protectorates.

On the other hand, non-official commercial opinion in India strongly objected that the Agreement whittled down the Fiscal Autonomy Convention, as well as certain valuable principles of discriminate protection established since 1923. There was also absence of reciprocity, the Agreement being drawn more in the interest of the United Kingdom than of India. While India gave definite undertakings, the United Kingdom merely offered to consider various steps that might be taken to develop the use of Indian cotton, etc., and extended vague promises to India of little or no material use in the near future.

It was also argued that the Agreement enunciated principles far more dangerous than any quotas or reductions in the percentages of duties. It was not desirable to reopen the question of protection when once it had been granted for a definite period, especially at the instance of the United Kingdom. Such a policy was likely to be an impediment to the industrial development of India and to hamper the starting of new industries.

The supplementary Indo-British Trade Agreement lapsed with the expiry of the Ottawa Trade Agreement and was not thereafter renewed.

§8. **The Assembly's adverse verdict on the Ottawa Agreement.**—On 30 March 1936 the Indian Legislative Assembly turned down by a resolution the Ottawa Agreement and its sequel the Indo-British Trade Agreement (1935) and voted against their continuance.

The Government of India being committed to abide by the decision of the Legislative Assembly, the six months' notice of termination of the Agreement was given on 13 May 1936 and the Agreement consequently was due to end on 13 November 1936. This period of notice afforded an opportunity of concluding a new agreement. Negotiations were set on foot between the British Government and the Government of India, who were assisted by a panel of non-official advisers led by Sir Purshotamdas Thakurdas. A Commerce Department *communique* dated 20 October 1936 stated that pending the conclusion of a new agreement the two Governments agreed that the 1932 Agreement should continue in force subject to termination at three months' notice by either party unless it was replaced by a new Agreement. Also that in the event of failure to conclude a new Agreement, neither party should withdraw the existing preferences without prior consultation with the other party.

§9. **The Indo-British Trade Agreement (1939).**[1]—After protracted negotiations lasting for nearly two and a half years a new Agreement to replace both the Ottawa and the Supplementary Agreements was concluded in March 1939 and the necessary legislation to give effect to it was put through, the Governor-General using his power of certification. The new Agreement contained notable modifications of the Ottawa Agreement. While keeping as large a proportion as possible of India's exports within the preferential field, much the same as under the Ottawa Agreement, the scope of preferences granted to the United Kingdom was considerably narrowed by excluding articles under food, drink and tobacco and raw materials or semi-manufactured goods which were entitled to preference under the old arrangement. Under the new Agreement the majority of the items related to specialized products not manufactured in India (e.g. motor cars, cycles, etc.).

As regards other items (e.g. woollen carpets and rugs, drugs and medicines, etc.), the imports from the United Kingdom consisted of special varieties which were produced in India only in negligible quantities. Certain preferential heads were redefined so as to exclude in the interest of the Indian consumer a number of commodities which were formerly included. Thus, under the head of chemicals, drugs and medicine, several acids and chemical products were removed from the scope of preference. A notable departure from the Ottawa Agreement was that

[1] See Madan, op. cit., postscript, pp. 222-49, and B. P. Adarkar, *The Indian Fiscal Policy*, pp. 559-62, for a detailed analysis and criticism of the Indo-British Trade Agreement.

while that Agreement had left untouched commodities which enjoyed protection in India, the new Agreement incorporated the arrangement regarding the duties on Lancashire goods although officially the Indian textile industry was a protected industry. Thus now it was more 'a case of protection within preference than of preference within protection'.[1]

India accorded a preference of 10 per cent to a number of items of imports of British goods like chemicals, paints, remnants of piece-goods, woollen carpets, sewing machines; and $7\frac{1}{2}$ per cent on motor cars, motor cycles and scooters, cycles and omnibuses, etc.

The United Kingdom on her side, apart from continuing the free admission of certain Indian goods (such as lac, raw jute, mica slabs, myrobalans), granted the following main preferences: (i) a preference of 10 per cent *ad valorem* to bones, linseed, castor-seed, groundnuts, leather (undressed), coir yarn, soya beans and spices, etc.; (ii) a preference of 15 per cent among other things to certain jute manufactures such as cordage, cables, ropes and twine, castor oil, rapeseed oil, linseed oil, groundnut oil, leather (dressed), paraffin wax; (iii) a preference of 20 per cent on coir mats and matting, cotton manufactures and certain jute manufactures like sacks and bags, and (iv) preferences at specific rates to magnesium chloride (1*s.* per cwt.); handmade knitted carpeting and floor rugs (4*s.* 6*d.* per sq. yard); coffee (9*s.* 4*d.* per cwt.); tea (2*s.* per lb.); rice ($\frac{2}{3}$*d.* per lb.).

As regards pig-iron, while it continued to enjoy free entry, the British Government reserved to itself the power to impose after 31 March 1941 a customs duty on imports of Indian pig-iron if after the expiry on that date[2] of the Iron and Steel Protection Act (1934), duties were applied to articles of iron and steel imported into India substantially less favourable to the United Kingdom than those provided for in that Act.

The separation of Burma from British India was responsible for the abolition of some preferences (e.g. pig-lead, rice meal, etc.) and reduction in the value of others (e.g. teakwood, paraffin wax, rice and tobacco, manufactured).

We have already fully explained in an earlier chapter how under the new Agreement a sliding scale of duties was fixed for cotton piece-goods which was linked, on the one hand, with the export of Indian cotton to the United Kingdom, and on the other, with the imports of cotton piece-goods from the United Kingdom into India. This was indeed the pivotal part of the Agreement.

As regards the Colonies, the new Agreement differed from the Ottawa Agreement in one important respect, viz. that provision was made in the new Agreement for the negotiation of a separate trade treaty with Ceylon, which was to enjoy the Ottawa schedule of preferences for a period of six months after the Agreement came into operation.[3] The schedule of mutual preferences between India and the Colonies remained unchanged with one or two exceptions.

[1] B. P. Adarkar, *The History of the Indian Tariff*, p. 560.

[2] The life of the Act was extended by another year.

[3] This period expired on 15 February 1940. Owing, however, to the difficulties experienced by the Government of India in securing a satisfactory solution of the problem of Indian immigrants in Ceylon the talks for a trade agreement between the two countries proved to be abortive.

Generally speaking, the new Agreement failed to secure the approval either of the Indian textile industry or of Indian commercial organizations generally.

In the first place, the Government's action in certifying the Bill to implement the new Agreement and disregarding the adverse verdict of the Assembly caused keen resentment, especially in view of the Government's previous adherence to the Assembly's decision when the Ottawa Agreement was denounced in 1936 and of the Fiscal Commission's recommendation to the effect that no preferences should be granted by India without the approval of the Indian Legislature.

Secondly, the Agreement ignored the then position of India as a debtor country with heavy liabilities to the United Kingdom by way of large items of 'invisible' imports and the consequent need of maintaining an export surplus in the balance of trade accounts. The Government also ignored the recommendations made by the unofficial advisers in respect of the claims of Indian insurance companies, Indian banking companies and Indian shipping for obtaining protection against discriminatory action and for securing equal opportunities and a specific share in the carrying trade for Indian shipping. In evaluating the new Trade Agreement it was also necessary to allow for preferences granted to the United Kingdom under the Indian Steel Protection Act.[1]

Also the general preferences enjoyed by the United Kingdom in the Indian market were in excess of those recommended by the unofficial advisers and precluded India from entering into any Trade Agreement with Continental countries, as India could offer them very little in exchange for her exports.

Again, while the preferences which India received in the United Kingdom had mostly a negative insurance value, the preferences granted by her to the United Kingdom, though on a smaller trade value, were of real benefit to the latter in so far as these related to heads of imports in which the keenest competition was met with by United Kingdom exporters. While the official estimate of the value of the Indian export trade enjoying preferences was Rs. 36·86 crores, as against Rs. 7·68 crores which was the value of the imports from the United Kingdom falling in the preferential category, the value of the Indian export trade to the United Kingdom enjoying effective preference (e.g. linseed, oilseed cake, woollen carpets and rugs) was according to the unofficial advisers estimated at only Rs. 6 crores. It was misleading to include in this estimate the duty-free articles, as the United Kingdom could not afford to impose any import duties on these articles (e.g. raw jute) as they were of the character of essential raw materials required by important British industries. Further, while the preferences enjoyed by the United Kingdom related to manufactured articles such as chemicals, paints, instruments and apparel, which were directly detrimental to the growth of indigenous industries, the United Kingdom granted preferences only to raw materials required for keeping her industries going and for her armament programme.

Turning to preferences granted to Indian exports, further points of criticism were the loss of preference on wheat (the withdrawal of the old preferences with a view to affording freer access for American wheat to the British market being justified on the ground that the wheat preference was of no practical significance

[1] See *Indian Textile Journal* (April 1939), 'The Indo-British Trade Pact' by Dr V. K. R. V. Rao.

to this country); the reduction of the preference on rice; the refusal of the British Government to withdraw the drawback facilities in respect of linseed utilized in the manufacture of linseed oil; the reduction of the preference on chrome leather; and the reduction in the margin of preference enjoyed by hand-made Indian carpets.

The most persistent criticism was levelled against the arrangement for linking up the export of Indian raw cotton to Lancashire with imports of British piece-goods in this country. This arrangement ignored the recommendations of the unofficial advisers and there was no adequate *quid pro quo* so far as India was concerned (see ch. ii, §13). So far as the question of the purchase of an agreed quantity of raw cotton by the United Kingdom was concerned, the stipulated quantities did not mean any special sacrifice on the part of the United Kingdom by absorbing additional quantities of Indian cotton and thus giving the promised relief to the Indian cotton grower, and fell short of the normal offtake of Indian cotton by the Lancashire cotton industry. On the other hand, India was asked to guarantee, with the aid of effective sanctions, the intake of United Kingdom cotton piece-goods far in excess of the actual quantity of Lancashire imports into India before the Agreement. Further, no mention was made about the proportions of different varieties of Indian cotton in spite of the demand of the Indian cotton growers that at least 65 per cent of the offtake should be short-staple cotton. Again, in spite of the declaration of the unofficial advisers that any further indirect taxation or burden put on the Indian cotton industry would necessarily call for similar countervailing increases in the duty on imports of cloth, the import duty on long-staple cotton was doubled. This reduced the protection available to the Indian cotton mill industry, had an adverse effect on the handloom industry and prejudiced in advance the examination of the new trade proposals.

On a broad review the new Agreement marked a partial improvement over the Ottawa Agreement. So far as the mutual exchange of preferences was concerned, barring the Cotton Article, it was a fair deal on the whole. As regards, however, the arrangement for the linking of the intake of Lancashire piece-goods with the offtake of Indian cotton, the scales were heavily tipped in favour of Lancashire, having regard especially to the doubling of the duty on the import of raw cotton into India. While the terms offered by the unofficial advisers to Lancashire were not sufficiently attractive, it would have been a fair arrangement, if either of their recommendations[1] in respect of the export of Indian raw cotton or the import of Lancashire goods had been incorporated in the Agreement; thereby a more acceptable basis for settlement would have resulted.

§10. **Genesis of the Indo-Japanese Trade Agreement (1934).**—We have already[2] referred to the denunciation of the old Indo-Japanese Trade Convention of 1904 by the Government of India in April 1933. The continuous depreci-

[1] The unofficial advisers proposed 200, 300 and 400 million yards respectively as the minimum, medium and maximum limits of imports of United Kingdom cotton piece-goods against 350, 425 and 500 million yards embodied in the Agreement. As regards raw cotton, the unofficial advisers demanded that the United Kingdom should guarantee a minimum intake of 650,000 bales with an objective figure of one million bales, while in the Agreement it was stipulated that the United Kingdom would import 500,000 bales in 1939, 550,000 in 1940 and 600,000 bales thereafter.

[2] See p. 28.

ation of the yen from the beginning of 1932 placed Japanese exports to India in a very favourable position towards the end of 1932-3. Indian mills were faced with a serious crisis and the Government of India had to intervene. The increase in the import duties to 50 per cent *ad valorem* with a minimum specific duty of 5¼ as. per lb. on plain grey non-British cotton piece-goods in August 1932 was insufficient to meet the Japanese competition, and the Indian textile industry continued to agitate for additional protection. His Majesty's Government on behalf of the Government of India were thereupon compelled to give the necessary six months' notice to the Government of Japan of their desire to abrogate the old Trade Convention (1904) under which Japan enjoyed the privilege of the most-favoured-nation treatment. So long as the trade convention of 1904 remained in force it was not possible for the Government of India to take any action against Japan alone under the Safeguarding of Industries Act, passed in April 1933 by the Indian Legislature, which empowered the Government to take tariff action whenever the trade and industry of the country was threatened by cheap imports from foreign goods. The decision of the Government of India to denounce the Indo-Japanese Trade Convention led to a movement in Japan for the boycott of Indian cotton by way of reprisal. But the agreement between the Japanese spinners and raw cotton dealers not to accept Indian cotton was not definitely reached until after the promulgation in India of the tariff changes of June 1933, which announced an increase in the duty on foreign (including Japanese) cotton piece-goods to 75 per cent *ad valorem* with a minimum specific duty of 6¾ annas per lb. on plain greys. A Japanese delegation came to India in October 1933. After negotiations lasting more than three months, an agreement was reached between the two sides. The Japanese boycott was withdrawn in January 1934 and at the same time the 75 per cent duty was reduced to 50 per cent by the Government of India. A new reciprocal commercial treaty was drawn up, and was signed in London on 12 July 1934, although the provisions relating to the regulation of imports of Japanese piece-goods had come into force earlier, i.e. on 8 January 1934.

§11. **Provisions of the Agreement (1934).**—The Agreement of 1934 with Japan consisted of two parts, the Convention and the Protocol. The Convention laid down in broad outline the trade relations between the two countries in future, and the Protocol specified the agreement reached regarding the importation of cotton piece-goods from Japan into India and the export of raw cotton from India to Japan. The Protocol without the Convention was to come to an end automatically on 31 March 1937, and the Convention would terminate on the same date, if denounced by either of the contracting parties by giving six months' notice.

The main provisions of the Convention were as follows: (i) Both the contracting parties agreed to extend to each other the most-favoured-nation treatment. (ii) At the same time both the parties had the right of imposing or modifying from time to time special customs duties on the imports from each other at such rates as might be necessary to correct the effect of any variation in the exchange value of the yen or the rupee in relation to the rupee or the yen respectively, subsequent to 31 December 1933. (iii) While both the parties reserved the right to make such changes in their customs tariffs as might be necessary for the protection of their own interests, they were agreeable, when requested to do so

by either party, to enter into negotiations with the object of reconciling as far as possible the interests of the two countries.

The principal articles of the Protocol were as follows:

(i) The customs duties to be imposed on importations into India were not to exceed the following rates:

(*a*) *Plain greys.* 50 per cent *ad valorem* or 5¼ annas per lb., whichever is higher; (*b*) *Others.* 50 per cent *ad valorem.*

(ii) The Protocol prescribed a system of quotas for the imports of Japanese cloth into India and the export of raw cotton from India. Under this arrangement Japan was allowed to export to India in any cotton piece-goods year (i.e. the year beginning on 1 April) 325 million yards of cloth (exclusive of re-exports) provided she purchased one million cotton bales from India in any cotton year (i.e. the year beginning on 1 January). This was the basic quota. The largest quantity of cotton piece-goods that Japan could send to India was fixed at 400 million yards a year. For this purpose the basic allotment of 325 million yards was to be increased by 1½ million yards for every 10,000 bales of the excess over 1 million bales taken in any cotton year.

(iii) The sub-allotment of the cotton piece-goods which might be sent to India in any year was divided into four categories as follows:

(*a*) Plain greys 45 per cent. (*b*) Bordered greys 13 per cent. (*c*) Bleached (white) goods 8 per cent. (*d*) Coloured (printed, dyed or woven) goods 34 per cent.

§12. **Working and results of the Indo-Japanese Trade Agreement (1934).**— The conclusion of the Indo-Japanese Trade Agreement of 1934 removed the ill-feeling prevailing in both the countries and brought relief to the cotton grower, the cotton merchant and, to a certain extent, to the mill-owner in India. The greatest gain from the Agreement was secured by the Indian cotton grower, who succeeded in exporting to Japan cotton in quantities appreciably larger than the quota fixed under the Agreement. The betterment of his economic position was also calculated to help the local textile industry since the masses are the largest consumers of local fabrics.

Japan also realized substantial advantages. In the first place, she secured the most-favoured-nation treatment. The reduction in the customs duty on Japanese exports of piece-goods to India from 75 per cent to 50 per cent, which, in the opinion of Indian mill-owners, gave inadequate protection to the industry, was also another big gain to Japan.

From the Indian standpoint the Indo-Japanese Trade Agreement of 1934 was adversely criticized, and the feeling in the country was that India did not come off well in the bargain. The greatest dissatisfaction was expressed against the working of the quota system. The non-official advisers to the Government of India in the Indo-Japanese trade parleys for the renewal of the Trade Agreement, which began in July 1936, declared that the quota arrangement had lent itself to considerable evasion. The Japanese as well as the Indian merchants in Japan promptly took advantage of the loopholes in the quota system, and thus frustrated its main object, namely the limitation of the amount of cloth coming from Japan. Fents[1]

[1] Fents are rejected cuttings of cloth pieces which are imported at a smaller customs duty, being below the standard length.

were outside the quota and there developed a big trade in them. So also artificial silk goods were not included under the quota, and large quantities of them were imported into India from Japan. Another ingenious method adopted by Japanese exporters to circumvent the quota arrangement was to send made-up cotton goods such as shirts, dresses, skirts, etc., which flooded the Indian market. It was also alleged that considerable quantities of Japanese piece-goods, re-exported from India to Afghanistan and Nepal, were smuggled back across the border into British Indian territory. Thus it was shown that Japanese exports to India had in spite of the Protocol increased, and thus defeated its agreed purpose. The linear yard basis had been abused, and cloth of greater width had been exported to India.

It was further pointed out that Japan had taken full advantage of the most-favoured-nation clause in the agreement, and had dumped large quantities of cheap miscellaneous manufactured goods such as glassware, boots, shoes, hardware, woollen goods, cycles and umbrellas. This had adversely affected the position of a number of small nascent Indian industries and handicrafts. Customs statistics showed that the imports of miscellaneous Japanese products into India had risen by several crores of rupees, so that Japan's adverse balance of trade with India had been wiped out. Japanese purchases of Indian pig-iron, jute and oilseeds had considerably diminished. On the other hand, the range of goods imported from Japan, as also the quantities imported, had appreciably increased. It was, therefore, argued that a comprehensive trade agreement was necessary rather than an agreement restricted to the barter of raw cotton against cotton piece-goods.

As regards the large purchases of Indian cotton made by Japan in excess of what the Protocol contemplated, it was urged that Japan bought all this cotton because she wanted a cheap raw material. During 1934-5, the first complete year during the operation of the Indo-Japanese Trade Agreement, she bought 2,010,600 bales of Indian cotton. Her average cotton takings from India for the previous ten years were a million and a half bales. It was, therefore, maintained by non-official commercial opinion in India that the minimum offtake of Indian cotton by Japan should be increased from 1 million to at least 1½ million. It was argued that the cotton offtake of Japan would not diminish for some years unless the Japanese replaced cotton in their industries by staple fibre.

§13. **New Indo-Japanese Trade Agreement (1937).**—All these points of criticism against the Indo-Japanese Trade Agreement of 1934 received a great deal of attention during the protracted negotiations which commenced in July 1936 for the renewal of the Trade Agreement of 1934 which was to expire on 31 March 1937. The non-official Indian advisers to the Commerce Department of the Government of India were united in their demands, as they had not been in 1933. In the first place, it was recommended that while the old agreement concerning the Japanese offtake of Indian cotton should continue, there should be a substantial reduction (say by fifty million yards) in the quantities of Japanese cotton piece-goods imported into India. It was also urged that there should be a quota for fents and that it should not exceed an amount equal to 2½ per cent of the general cotton piece-goods quota. It was further proposed that to check the growing imports of artificial silk piece-goods into India from Japan, these goods should be included in the general piece-goods quota. The same procedure was to be adopted for

made-up cotton-cloth garments. The quota was to be fixed on the square-yard basis instead of the linear yard basis. A further recommendation was that low-grade Japanese yarn (that is, yarn of staples up to 50*s*) should be subject to a quota. Finally it was urged that under the new agreement there should be either quotas for imports of miscellaneous goods, or such higher specific import duties as would protect the small home industries of India.

The revised Indo-Japanese Trade Agreement came into force from 1 April 1937 and was to have effect until 31 March 1940.

As regards the Trade Convention the *status quo* was preserved and Japan was thus assured of the most-favoured-nation treatment for a period of three years.

The revised cotton Protocol was substantially the same as the old one except for a few modifications, some of which were necessitated by the separation of Burma from India from 1 April 1937. The annual basic import quota of Japanese piece-goods was reduced from 325 million yards to 283 million yards against the purchase by Japan of Indian raw cotton of one million bales. The reduction was effected in view of the shrinkage of the Indian market following the separation of Burma from India. Similarly the maximum limit of imports of cotton piece-goods, which was conditional on Japan's taking 1½ million bales of raw cotton from India, was reduced from 400 to 358 million yards.

In the new Protocol, the coloured piece-goods were subdivided into the categories of (i) printed goods and (ii) dyed or woven goods, and the percentage quota apportioned to coloured piece-goods was increased from 34 to 37. The basic quota of cotton piece-goods was exclusive of the cotton fents, but Japan undertook to limit imports of cotton fents into India to 8,950,000 yards annually. The Government of India agreed that customs duties on cotton fents would not exceed 35 per cent *ad valorem*.

The new Agreement with Japan, which came into force from 1 April 1937, fell short of the unanimous recommendations made by the non-official advisers to the Government of India and was scarcely better than the old Agreement of 1934. The Government of India could have secured better terms, including protection of the minor industries, which had been suffering owing to Japanese competition. The Trade Convention had been continued on the existing basis without reference to the demand for protection against Japan put forward on behalf of the small indigenous industries. The *status quo* had thus been preserved in the general trade relationship between the two countries. The Agreement was to that extent a gain for Japan.

As regards the cotton Protocol, the main difference from the previous one was, as explained above, necessitated by the separation of Burma with whom Japan had already concluded an agreement under which the Burmese quota for Japanese piece-goods had been fixed at 42 million yards. The Indian quota had accordingly been reduced by an equivalent amount. It should be borne in mind, however, that Burma's requirements were estimated at about 70 million yards annually, when the basic quota of the old Protocol was fixed. Since the separate Burmese quota had been fixed at 42 million yards only, India had to absorb 28 million extra yards, as her quota was reduced by 42 million yards only and not by 70 million yards as it ought to have been.

It was also objected that cotton fents had not been included in the quota of cotton piece-goods, although the maximum quantity of cotton fents that might be exported to India annually was limited to 8,950,000 yards, i.e. 2½ per cent of the quota of cotton piece-goods.

The exclusion of silk fents and artificial silk piece-goods from the scope of the Agreement was also adversely criticized. But the Indian mill industry and the indigenous silk industry were assisted by the Finance Department Notification (1937) prohibiting imports of artificial silk fents into India and the raising of the import duties on artificial silk piece-goods by an average of an anna per square yard.

Some of the suggestions made by the non-official advisers were not accepted; for example, no quota limitation was placed on the extraneous imports of made-up goods, towellings, cotton blankets, and re-exports over India's land frontiers to the neighbouring markets of Nepal and Afghanistan.

Disappointment was also felt that the Government of India did not take the opportunity offered by the Trade Agreement to check the intrusion of Japan into the coastal shipping trade of India and to ensure for India a fair share in the carrying trade between Japan and India.

In support of the new Indo-Japanese Agreement it was said that the interests of the cotton grower had to be safeguarded first, and in view of the threat of Chinese cotton strengthened by the new five-year plan it was gratifying that the offtake of Indian cotton for three years had been stabilized.[1] In this connexion we should do well to remember that India needed an effective outlet for much of her cotton. The Indian mills absorbed roughly 50 per cent of the five million bales of cotton produced in the country. The European market could only absorb a small percentage of our cotton. It was therefore important not to lose the Japanese market.

The Agreement of 1937 on the whole made India's position stronger than before. It was felt, however, that we did not utilize our bargaining power to the fullest extent. Also it would have been very desirable if instead of a barter agreement of raw cotton against cotton piece-goods, a comprehensive trade agreement, including proper safeguards for the nascent small industries of India like glass and glassware, hosiery, soap, enamel ware, chemicals, etc., had been concluded with Japan.

§14. **Provisional Agreement of 1940.**—The Government of India decided in December 1939 not to give the necessary six months' notice of termination of the Trade Convention with Japan in view of the assurance they received that the Government of Japan had not the least intention to take advantage (by tolerating heavy shipments of Japanese goods to India) of an interval that might arise between the termination of the Protocol and the Convention in the event of serious delay in the negotiations.

On the expiry of the Protocol on 31 March 1940 the two Governments agreed

[1] It should be noted, however, that owing to the Sino-Japanese war and the difficulties experienced by Japan in commanding foreign exchange, she considerably reduced her purchases of Indian cotton, the figure of export from India being 1,359,092 bales of cotton in 1937–8 as compared with 2,426,049 bales in 1936–7.

that during the period intervening between expiry and the framing of a new Agreement they would take no action to prejudice each other's trade.

The prospects of concluding an early trade agreement with Japan appeared to be very gloomy in view of the announcement by the British Government of the denunciation of the trade treaties with Japan (July 1941). Accordingly the requisite six months' notice of termination of the Indo-Japanese Trade Convention of 1934 was given to Japan.

§15. **New Indo-Burma Trade Agreement (1941).**—The trade relations between India and Burma after the separation of the latter as from 1 April 1937 were governed, until the conclusion of a new Trade Agreement between the two countries, by the Indo-Burma Regulation Order-in-Council. It provided for the maintenance of the *status quo* in trade and tariff matters between the two countries. The Government of Burma, who found the free trade regime thus introduced unsuitable in view of their budget difficulties and need for customs revenue, gave notice on 1 April 1940 to terminate the Trade Regulation Order with effect from 1 April 1941. In the meantime negotiations for a new trade agreement were set on foot and after many hopes and fears resulted in an agreement acceptable to both parties.

The new Agreement, which was signed early in April 1941, put an end to the old free trade regime, both the Governments being free to impose tariff duties, subject to the reciprocal concession that their general tariff rates would give margins of preference to goods of India and Burma as the case might be of 10 per cent against Empire and 15 per cent against foreign goods. Subject to these provisions, the contracting parties undertook to accord each other the most-favoured-Empire-nation treatment.

The main features of this Agreement were:

(i) *Concessions by Burma to India*: (*a*) Burma undertook to accord free entry to some 77 articles such as canned fish, coal, raw cotton, cotton twist and pig-iron; (*b*) not to tax certain goods at rates in excess of 5 per cent (e.g. potatoes, coconuts, chemicals, drugs and medicines, paints, woollen blankets, rugs, etc.); (*c*) not to tax certain goods (e.g. coffee, cigars, certain spices, toilet soap, boots, shoes, etc.) at rates in excess of 10 per cent. (*d*) Lastly certain goods when imported into Burma were to be taxable at special rates not exceeding those shown below, e.g. betel nuts, 20 per cent; ale and beer at the rate of the excise duty; tobacco, one anna per pound; silk, artificial silk and mixed fabrics, 15 per cent, and so on.

(ii) *Concessions by India to Burma:* India agreed (*a*) that certain goods of Burmese origin (e.g. dyeing and tanning substances, gums, resins and lac, wood and timber, lacquered ware, iron ore, aluminium, lead and zinc) were to be accorded free entry; (*b*) that certain goods were to be dutiable at special rates, e.g. potatoes and onions, 5 per cent; coffee, 10 per cent; cigars, 10 per cent; tobacco (unmanufactured), one anna per pound. (*c*) It was found necessary to regulate separately the tariff treatment of Indian cotton piece-goods exported to Burma and of Burmese kerosene exported to India. As regards cotton piece-goods, while the Agreement provided for a margin of 7½ per cent only, the Burma Government pledged themselves not to fix the duty on such goods at more than 10 per cent. Further, the position of Indian textiles in Burma was strengthened by the reten-

tion of a quota on Japanese goods. As regards kerosene, while the margin of preference was reduced to nine pies per gallon as against the former margin of eleven and a quarter pies, the Government of India obtained the right during the period of war to impose a surcharge equal to the entire margin of preference. The surcharge came into effect on 7 April 1941. (*d*) It was also found necessary to deal separately with exports of timber to India and of imports of sugar into Burma. The Burma Government undertook not to impose an export duty on timber during the period of the war. Burma undertook to accord special privileges to sugar imported from India in so far as the local capacity to meet demand, left a margin to be filled by imports. (*e*) Rice and broken rice were to be retained on the free list and no duty was to be levied in India on these commodities coming from Burma so long as they were allowed to be imported free of duty from other countries. In case a duty was imposed on broken rice a preference not in excess of 10 per cent on the amount of the duty was to be granted to imports from Burma. (*f*) As regards exports from one country to the other which were liable to excise duty (e.g. motor spirit, matches, salt, sugar) it was provided in general that the rate of the customs duty should correspond to the level of the excise duty ruling in the country of imports. The Agreement was to run for an indefinite period subject to the right of either party to denounce it at six months' notice.

§16. **The new policy of bilateral trade agreements.**—An outstanding feature of the history of recent commercial policy, especially since 1932, has been the increasing activity displayed by a number of trading countries, particularly in Europe, in the conclusion of short-term bilateral trade agreements. This offers a striking contrast to the old trade policy, based on the most-favoured-nation principle, which was until recently widely in operation.

Of the many types of bilateral agreements the most common are: (i) Clearing and (ii) Compensation or Barter Agreements. The latter provide for the direct exchange of goods and thus obviate the necessity of devising means of payment. Such agreements may be entered into between two Governments or two private persons or firms in the two countries. The clearing agreements do not specify the particular commodities to be exchanged. They are designed mainly to regulate bilateral trade so as to produce as far as possible an exact balance of exports and imports and to regulate foreign exchange.[1] It is no doubt still customary to insert the most-favoured-nation clause in such bilateral agreements; but the operation of the clause is rendered nugatory by the simultaneous inclusion of provisions relating to financial and quota arrangements, industrial undertakings, regional preferences, etc.

The business community in India viewed with great alarm the deterioration of India's trade balance in merchandise, particularly during the depression of 1929-33, owing to the imposition of various restrictions by India's foreign customers, especially in Europe, in the form of prohibitions, monopolies, quotas, exchange restrictions, licence systems, etc. The general tendency to planned trade on the basis of trade treaties and the example of the United Kingdom itself in con-

[1] See *Press Note III on India's Foreign Trade Policy* (1936) issued by the Director of Information with the Government of India; also Paul Einzig, *Exchange Control*, pp. 151-2.

cluding such treaties strengthened the movement in India for a comprehensive policy of trade development through bilateral trade agreements. In the period before the outbreak of war in September 1939, the Government of India were urged to enter into bilateral agreements with all the important countries with which India had commercial relations, especially with Germany, Italy, Iran and Turkey, whose policies of regulated commercial exchange had particularly serious repercussions on India's export trade. The issue before the country was: should India abandon her traditional policy of the universal most-favoured-nation treatment in favour of a system of bilateral trade agreements? Point was lent to this controversy by the vote of the Legislative Assembly (March 1936) in favour of the termination of the Ottawa Agreement.

While the Government of India seemed thus to be committed to the policy of bilateral treaties, they were not convinced of the desirability of adopting such a policy. In their judgement nothing in the study of the world economic conditions in the past few years, or in India's existing circumstances, had shown that any departure from the accepted policy was necessary.[1] It was urged that India's export trade consisted mainly of comparatively few raw materials sent to the great world markets, and it was essential for her prosperity that she should have a favourable balance of trade and should have, to the greatest extent possible, free and unrestricted access to these markets. She could therefore ill afford to risk the closing of any door open to her by virtue of most-favoured-nation rights. Not only did bilateral trade agreements tend to produce immediate diminution of the total trade of the contracting parties, but the diversion of trade from its natural channels was also likely to inflict serious damage on third parties. The policy of preferring a favourable balance to an increase in the total volume of trade must lead to the extinction of all trade balances and the permanent shrinkage of international trade. India stood to lose rather than to gain by adopting a policy which at best would reduce her foreign trade to a balance of exports and imports. Restriction of imports, it was maintained, might be a regrettable necessity in the case of 'distress' countries like Germany, but the adoption of such a measure by reasonably prosperous countries like India would be sheer defeatism.

As regards bilateral agreements with countries like Germany,[2] Italy, Iran, Turkey, etc., it was necessary to bear in mind that India had normally a favourable balance of trade with these countries, i.e. she sold more to them than she bought from them. A country which was prepared to restrict its imports would always drive a hard bargain with another anxious to sell. Moreover, the exports of these countries to India would directly compete with the products of Indian industries. Further, India no longer held a dominant position in the world's markets as a supplier of food and raw materials. For instance, Germany was obtaining large quantities of raw materials formerly bought from India from countries with whom

[1] The grounds on which this conclusion was based were set forth in the Press Notes issuedin March 1936 by the Director of Information with the Government of India regarding India's foreign trade policy. See also B. K. Madan's article, 'Bilateralism and Indian Trade', *Indian Journal of Economics* (July 1938), as also his *India and Imperial Preference*, pp. 199-200.

[2] This refers to the trade position before the outbreak of war in September 1939.

clearing agreements had been made. Thus cotton was obtained from Brazil, Peru, Egypt and Turkey, hides and skins from South America, oil-seeds from the Argentine and the French Colonies, and so on. Allowance had also to be made for the fact that the uncertain character of the general economic conditions and of the currency situation in these countries might militate against sound bilateral agreements being made with them.

There were difficulties to be faced with other countries. For example, France was paying a great deal of attention to the encouragement of imports from her Colonies and had grown to like the milder and more delicate-flavoured China tea better than Indian tea. Again, the United States of America was still bent on its isolationist tactics and was concentrating on internal commerce and development rather than on foreign trade. Thus the chances of concluding successful bilateral agreements with these countries were very poor.

If a long view was taken, it appeared that India could not isolate herself from the world and retain her importance as a commercial unit. She must seek an outlet for her surplus produce in world markets, and her ultimate prosperity was dependent on the general prosperity of the world trading community. Her true interest therefore lay in the restoration of the free and unrestricted flow of international trade, on which world prosperity depends.

On the other side, however, it was argued that the prospects for world recovery and restoration of freedom in international trade were far from bright. The tendencies towards economic nationalism, self-sufficiency and bilateralism in trade were likely to be intensified rather than diminished in strength in the future. In these circumstances, India must fall in with the new policy of trade regulation in sheer self-defence, and she actually made a beginning in the Indo-British, Indo-Japanese and Indo-Burma Trade Agreements.

The United Nations Conference on Trade and Employment, held in Havana in March 1948, approved a charter for international trade and decided on the establishment of an international body called the International Trade Organization to serve as an instrument for promoting freer trade and preventing economic warfare among nations. The Havana agreement was signed by 53 nations after the way had been paved by the Geneva pacts between 23 nations agreeing to mutual trade concessions and tariff reductions. While the Havana charter commits all the signatories, of whom India is one, to the principle of relaxation of trade restrictions and abolition of discriminatory practices, it nevertheless permits the restrictions and discriminations in so far as they are seen to be necessary for the achievement of legitimate objects such as the rapid industrial development of backward countries, full employment and the overcoming of balance-of-payment difficulties.

The Havana charter gives full recognition to the most-favoured-nation principle, which means that any concession granted by one country to another is automatically extended to all the other signatories of the charter.

Thanks to the efforts of the Indian delegation to the Conference, suitable changes have been made in the charter so that its acceptance should in no way hamper the economic development of backward countries. On the contrary, it is clearly understood that international economic co-operation cannot be genuine unless the advanced countries assist the backward countries to develop their poten-

tialities fully by agreeing to the equal access to raw materials and by the provision of capital equipment and technical aid.

The success of the International Trade Organization must, however, depend on the maintenance of world peace. If the present (October 1950) threat of war persists, it must necessarily lead to the formation of rival economic blocs corresponding to political alignments, and Governments will again begin to think in terms of national self-sufficiency rather than of expansion of world trade and international economic co-operation.

During 1948-9 India signed commercial agreements with ten countries in pursuance of her policy of having direct trade with foreign countries instead of through the United Kingdom as in the past and also of conserving hard currency by drawing, so far as possible, on soft currency sources for the supply of essential capital and consumer goods.

CHAPTER VIII

CURRENCY AND EXCHANGE (PART I)

§1. **Indian currency in the pre-British era.**—Since Akbar's time the currency in northern India had come to consist of the gold mohur and the silver rupee, which both weighed 175 grains troy. There was no fixed legal ratio between them, though each of the coins bore a fixed ratio to the *dam*, the copper coin of the Mogul Empire.[1] In southern India, which never came completely under the dominion of the Moguls, gold was the principal currency. Under Hindu rule, preference was generally given to gold, while the Muslims showed a predilection in favour of silver. When the Mogul Empire broke up, a number of independent states arose on its ruins, and many of them signalized their independence and sovereignty by striking a special coin of their own. Though the old denominations were generally retained, there was every degree of variation as regards weight and fineness. So that when the East India Company came upon the scene, it found that the currency position was characterized by a bewildering multiplicity and variety of coins of gold and silver. It has been calculated that as many as 994 different coins made of gold or silver and of varying weight and fineness were current.[2] The services of professional shroffs (appraisers) had constantly to be requisitioned to ascertain the value of the coins held. The East India Company found its commercial transactions seriously hampered by this chaotic condition of the currency, and thus began the series of experiments in currency organization in India, whose history it is our purpose to narrate in this chapter.

§2. **The first period (1801-35).**—The history of Indian currency in the nineteenth century may be divided into four periods: (i) 1801-35; (ii) 1835-74; (iii) 1874-93; and (iv) 1893-1900.[3]

The first attempt of the East India Company at evolving order out of the prevailing confusion in currency resulted in a simultaneous issue of both gold and silver coins with the Company's stamp, and with a definite legal ratio, weight and fineness. But owing to the fluctuations in the market value of the two metals it was found impossible to maintain the ratio. Under the official ratio, gold was undervalued and was therefore displaced by silver. About this time Lord Liverpool published in England his famous *Treatise on the Coins of the Realm,* which enunciated the principle that only one metal should be the standard and unlimited legal tender, though other metals might also be coined and allowed to circulate at their market value. The Directors of the East India Company, seeking a way out of the currency muddle in India and influenced by Lord Liverpool's work, selected silver to function as the only standard in India. However, in 1806, in a dispatch to the Governments of Bengal and Madras, they took care to mention that their intention was by no means to drive gold out of circulation where it was the general measure of value. The Company tried to keep the ratio fixed between the rupee and the gold

[1] B. R. Ambedkar, *The Problem of the Rupee*, p. 3.

[2] H. D. Macleod, *Indian Currency*, p. 13.

[3] Shirras, *Indian Finance and Banking*, p. 93.

mohur, but the latter came to be undervalued, and disappeared from circulation. The recommendations of the Directors in 1806 had allowed discretion to the Indian authorities as regards the time and manner of giving effect to them, and they were not acted upon immediately. In 1818, however, the silver rupee of 180 grains, 11/12th fine, was substituted for the gold pagoda in the Madras Presidency. The coinage of gold pagodas in Madras was stopped, but, for the convenience of the public, it was announced that gold coins would be issued, and would be paid and received by all the public offices at such rates as might be determined by proclamation from time to time, the first rate chosen being 15 : 1.

In the meanwhile, the Bombay rupee had been made identical with the Madras rupee in 1823, and the last step was taken in 1835, when the Indian rupee was issued of the same weight and fineness as the Madras rupee of 1818, and was made sole legal tender of payment throughout the territories of the East India Company. Mints were opened to its free coinage, and the Indian system came to be one of silver monometallism, instead of the bimetallic or parallel standard system which had prevailed so far. The value of the silver bullion in the rupee and its legal value were identical. This Act remained in force up to 1893.

§3. **The second period (1835-74).**—The Act of 1835, however, authorized the coinage of gold mohurs and of five-, ten-, and thirty-rupee gold pieces at market value, if required by the public. In 1841, a proclamation was issued authorizing the public treasuries freely to receive the gold mohurs at their face value, that is to say, at the rate of 15 : 1, in payment of public dues. In 1848 and 1849, owing to the Australian and Californian gold discoveries, the price of gold fell in terms of silver. Gold was overvalued in the official ratio of 15 : 1, and the holders of gold coins availed themselves of the opportunity to obtain a larger price in silver than they could obtain in the market. People began to pay their public dues in the depreciated gold coins rather than in rupees, much to the embarrassment of the Government. Lord Dalhousie's Government, therefore, withdrew the proclamation of 1841, and gold was thus definitely demonetized. These steps led to a great stringency in the money market, which was particularly felt owing to the expansion of trade. After 1850 the production of silver was less than was the demand for it. Also a large proportion of silver rupees were being abstracted from circulation and being put to non-monetary uses. 'The Mint was pitted against the smelting pot, and the coin produced by so much patience and skill by the one was rapidly reduced into bangles by the other.'[1] There were no credit media to speak of to relieve the monetary stringency, and banking was yet in an undeveloped condition. In these circumstances people began to have recourse to their own remedy, as was pointed out by the Bombay Chamber of Commerce in a memorial to the Government of India praying for a gold currency, in which it was said that 'there is an increasing tendency to the creation of a gold ingot currency, by the natives of this country, as a rude remedy for the defects of the existing silver one', and 'that gold bars, stamped with the mark of Bombay banks, are for this purpose circulated in several parts of the country'.[2] The American cotton famine brought fancy prices in gold to Indian cotton exporters, and gold

[1] Cassels quoted by Ambedkar, op. cit., p. 34.
[2] Ambedkar, op. cit., p. 42.

was imported on a very large scale. There arose, therefore, a demand supported influentially by the three Chambers of Commerce for the introduction of a gold currency. In November 1864, therefore, the Government of India issued a notification by which sovereigns and half-sovereigns were to be accepted at Government treasuries at the rate of Rs. 10 and Rs. 5 respectively, and the Government of India were to pay sovereigns and half-sovereigns to their creditors when convenient, and if the latter desired to receive them in payment. In 1866 the Calcutta Chamber of Commerce again urged the adoption of a gold currency, and the Government of India appointed the Mansfield Commission, which was the first of the committees and commissions which have sat from time to time to deliberate upon the problem of Indian currency and have ladled out conflicting panaceas to cure the currency ills of the country. The Mansfield Commission recommended that (i) gold coins of 15, 10, and 5 rupees should be issued, as they were likely to be preferred by the people to notes of like values, and as the introduction of the gold currency would pave the way for the establishment of currency notes; and that (ii) the currency should consist of gold, silver and paper. In 1868, a notification was issued by which the rate for the receipt of sovereigns and half-sovereigns was raised from Rs. 10 and Rs. 5 to Rs. 10-8 and Rs. 5-4 respectively, as the former rate was out of harmony with the market rate and failed to attract gold to the public treasuries. In taking these steps, without any explicit reference to the Mansfield Commission, the Government showed their desire ultimately to make gold legal tender, but they wished to make sure of the fact as to the relative value of gold and silver in India before stereotyping the results by law and finally committing themselves to the legal tender of gold. In 1872 Sir Richard Temple submitted a note to the Government of India suggesting that a gold standard and currency was what was really wanted in India, and that a Commission should be appointed to decide definitely what should be the rating of gold and silver. The Council of the Governor-General were, however, not unanimous, and the second period in the currency history of India came to an end with the decision of the Government of India in 1874 not to accept the proposal.

§4. **The third period (1874-93).**—By 1874 a great change had begun in the monetary status of silver. Germany demonetized silver in 1873. Sweden, Denmark and Norway followed in 1874, closing their mints to the free coinage of silver. The countries of the Latin Union had to fall into line, with the result that huge quantities of silver were thrown on the market. There was also an enormous increase of output of silver from new mines and owing to improved processes. The demand for gold, on the other hand, was increasing owing to its introduction as the only standard in Europe and the United States, and to the general expansion of trade, while the supply was declining. Gold and silver became in their relation to each other simply commodities with no connecting monetary link. The depreciated metal began to flow on a huge scale into silver standard countries, and India more than ever became a sink for silver, which, as it came in, was largely coined into rupees by the Indian mints. This heavy coinage was one of the causes which set up a decided tendency towards a rise of prices in India, though the phenomenon became much more marked after 1900. From 58*d.* per ounce in 1875, the price of silver fell to 52½*d.* in 1879; 43*d.* in 1888; 37½*d.* in 1892; and

27*d*. in 1899. With the depreciation of silver the exchange value of the rupee in terms of the sovereign, that is to say, its gold value, began to move down, and fell from about 2*s*. in 1871 to about 1*s*. 2*d*. in 1892.

From 1874 up to 1878, the agitation for reform in India was directed chiefly to the closing down of the mints for the free coinage of silver, with a view ultimately to the adoption of the gold standard. In 1876, the Bengal Chamber of Commerce and the Calcutta Trade Association sent a memorial to the Governor-General requesting the temporary suspension of compulsory coinage of silver by the Indian mints. The Government, however, refused to grant this request, being of the opinion that, without the substitution of gold as a standard, no such step was possible, and that they were not able to adopt the gold standard under the prevailing circumstances, which were still unsettled; and lastly, that the uncertainty in the situation was caused not only by the depreciation of silver but also by the appreciation of gold. In 1878, however, the Government of India themselves proposed to the Secretary of State that definite steps should be taken in the direction of a gold standard with a gold currency, and that, in the meanwhile, the cost of the rupee should be increased to the public in India by charging an additional seigniorage in order to establish a definite relation between the gold coins and the rupee, which might, if necessary, be altered from time to time. The Secretary of State referred this proposal to a Committee, which opposed the scheme on various grounds, and advised, with a somewhat pontifical air, 'that it was better to sit still than to have recourse, under the influence of panic, to crude legislation the result of which cannot be foretold and the effect of which cannot be measured'. As an alternative to a gold standard, the Government of India pathetically clung for a long time to international bimetallism, with a devotion worthy of a Mrs Micawber, when practically every other nation was deserting it. Between 1867 and 1899, there were no less than four International Monetary Conferences held to propose remedies for the currency difficulties in the different European countries and the United States. India was throughout inclined in favour of international bimetallism mainly because of its special use for herself as a means of rehabilitating silver in the currencies of the world, which, she hoped, would raise the price of silver and thus extricate her from her exchange difficulties. But the scheme fell through chiefly because of the opposition of England and the general desire on the part of the other European nations to adopt the gold standard in imitation of England, which led them to take up an attitude of hostility to the introduction of bimetallism in the silver-using countries. They feared that the demand for gold which this would cause on the part of the silver-using countries would raise the price of gold to inconvenient heights and embarrass the countries of Europe, which were intent upon the establishment of their currencies on a stable gold monometallic basis.

§5. **The fourth period (1893-1900).**—In the meanwhile, the continued fall in the value of silver and the decision of the United States to repeal the Sherman Act, under which the Government of that country was required to purchase 54 million ounces of silver for annual coinage, made the position of silver and therefore the position of the Indian rupee more precarious than ever. In these circumstances, the Government of India again approached the Secretary of State in 1892 with the

proposal to close the Indian mints to the free coinage of silver with the object of eventually introducing the gold standard, if the International Monetary Conference then sitting at Brussels failed to arrive at any conclusion in favour of international action. Accordingly, in 1892, the Herschell Committee was appointed to consider the currency and exchange situation with special reference to the above proposal of the Government of India. While the Herschell Committee was still sitting, the Brussels Conference ended in a fiasco. The Herschell Committee had to suggest a remedy for the following principal defects of the Indian currency system as it then existed: (i) the financial difficulties of the Government of India caused by silver monometallism and the falling rates of exchange with the gold standard countries; (ii) the evil effects of the fall in exchange on the people of India and her commerce; (iii) the difficulties caused by the fall in exchange to European officials in India.

§6. (i) **The financial difficulties of the Government of India.**[1]—The difficulties of the Government came principally from the fact that they had to remit yearly a large sum of money to England in discharge of their gold obligations, viz. the Home Charges. The gold value of the rupee determined the actual incidence of this charge in India and, as we have seen, this value had been constantly falling ever since 1874, and there was every prospect of a further fall. The inconvenience to the Government of this state of affairs was well described by Sir David Barbour, the Finance Member of the Governor-General's Council from 1888 to 1893, as follows: 'The immediate cause of our financial difficulties, and the cause which, by comparison and for the time being, dwarfs all others, is the fall in the gold value of silver, which has added to the Indian expenditure in two years more than four crores of rupees. If that fall could be stayed and the rate of exchange with England fixed permanently at even its present low figure, the difficulty of dealing with the present deficit would be comparatively light. . . . Our financial position for the coming year is at the mercy of the exchange, and of those who have it in their power to affect in any way the price of silver. If we budget for the present deficit of Rs. 15,95,100 and exchange rises one penny, we shall have a surplus; if it falls a penny, we shall have a deficit of more than three crores; if we impose taxation to the extent of one and a half crores of rupees, a turn of the wheel may require us to impose further taxation of not less magnitude; another turn, and we may find that no taxation at all was required.'

§7. (ii) **Effect of fall in exchange on the people of India.**[2]—The increased number of rupees which the Government were required to find for meeting their sterling obligations meant more taxation in terms of rupees. This did not necessarily involve a permanent increase of the burden of taxation, for in course of time adjustment would have taken place by a rise in silver prices in India, so that a larger number of rupees would have meant the same quantity of produce, and it is the quantity of produce and not the number of tokens representing it that is the proper measure of the burden. A certain time, however, must elapse before the adjustment is completed, and in the meanwhile the Indian ryot would have to pay more in terms of produce. The Herschell Committee pointed out that although the burden upon the people as a whole might not eventually be greater, there was

[1] See *Herschell Committee Report*, pars. 3-6. [2] ibid., pars. 32-4.

likely to be a transfer of burdens from one class to another. Owing to the fall in exchange, the burden of those who paid a fixed land revenue under a permanent settlement had been lightened, and so had the burden of those whose land revenue had not been recently resettled. On the other hand, the increased salt tax pressed upon the people at large, and rendered more heavy the taxation of those who had suffered from the higher rupee prices due to the fall in the gold value of silver.

Leaving out of account temporary gains and losses to exports and imports[1] respectively, an important argument against letting things alone was that about 74 per cent of the total imports of India came from gold-using countries, while 26 per cent only came from silver-using countries. Intimate financial and commercial relations had thus been established with gold standard countries, and a constant fall in the value of the rupee must of necessity seriously embarrass India's foreign trade and have the result of introducing an unhealthy element of speculation into it. Further, even if the falling rupee conferred a temporary benefit on the employer in India, this was at the expense of the wage-earner, because wages rise more slowly than prices. Thus, considering the benefit to India as a whole, it could not be said that a continuous fall in exchange was an advantage.

In view of the difficulties caused both to Government finance and to the commercial community, it would be difficult to find much fault with the Government's anxiety to give up the silver standard in favour of the gold standard. The alternative method of increasing taxation, especially taxation in the form in which it would not have been unpopular, namely, by means of import duties, and of severe retrenchment in public expenditure, was no doubt not absolutely impossible. But given the prospect of constant fluctuations in the value of the rupee, continuous resort to taxation and economy would have been extraordinarily difficult and unsettling in its effect.

§8. **Fall in exchange and foreign capital.**—The influence of a heavy fall in exchange was tending greatly to check the investment of British capital in India and the development of the country, which largely depended upon such investment. For, 'London is the lending market, and London thinks in gold'. The uncertainty as regards the interest on the investment and the prospect of the diminution which the invested capital might suffer, if it were desired to retransfer it to England, impeded the flow of British capital into India. Foreign firms were also finding a difficulty, owing to the falling exchange, in procuring the services of European servants, required for conducting their undertakings in India. The difficulty in attracting foreign capital to the country also had a prejudicial reaction on the finances of local bodies in India.

§9. **(iii) Position of European officials.**—The Indian Government were also faced with difficulties as regards their own officers, who began to put forward claims for compensation for the loss which they sustained owing to the fall in exchange. They received their salaries in rupees, and to remit a given amount in terms of sterling to England for the support of their families and the education of their children, they had to spend a larger and larger portion of their income than before. This had led to serious discontent among them.

§10. **Recommendations of the Herschell Committee.**—Having convinced

[1] On this point consult E. W. Kemmerer, *Modern Currency Reforms*, pp. 27-8.

themselves that the existing monetary system was in urgent need of reform, the Herschell Committee proceeded to suggest remedies. Bimetallism was now out of the question. But instead of demonetization of silver and the establishment of a gold standard currency, a sort of limping standard was recommended, under which there was to be no free mintage either of gold or of silver, and the rupee was to continue to be unlimited legal tender, gold being used only partially for currency purposes during the period of transition, at the end of which further steps were to be taken to introduce a full-fledged gold standard.

The Government of India approved of the Report, and in 1893 an Act was passed to amend the Coinage Act of 1870, and the Indian Paper Currency Act of 1882. It provided for the immediate closure of the Indian mints to the free coinage of silver, though the Indian Government were allowed to retain power to coin rupees on their own account. There were also three administrative Notifications issued at the same time. The first provided for giving rupees in exchange for gold coin and bullion presented at the Indian mints at the rate of 16*d.* to the rupee. The second Notification authorized the receipt of gold sovereigns and half-sovereigns in payment of public dues at the same rate. By the third Notification provision was made for currency notes being issued from the Paper Currency Offices, in exchange for gold coin or bullion, at the same rate.

The object of these provisions was, first, to force up the exchange value of the rupee, or rather to arrest its further fall; secondly, to encourage the import of foreign capital; thirdly, to familiarize the people with the use of the gold sovereign; and lastly, to discourage the import of silver. The general idea was to take the first steps towards the eventual introduction of the gold standard, and to link India with gold-standard countries immediately. It was thought that a period of transition was necessary before the actual establishment of the gold standard.

§11. **The Fowler Committee (1898).**—The currency position from 1893 onwards was avowedly transitional and provisional, and some definite action still remained to be taken. This was hastened by the representations of the commercial community, who were inconvenienced by the famishing of the money market through the closing of the mints and the temporary suspension of the sale of Council Bills, resulting in very high rates of discount. In the meanwhile, the rupee had been gradually gaining in exchange value,[1] and the time seemed to have arrived to place the Indian currency on a gold basis. This led to the appointment of the Fowler Committee in 1898.

Among the proposals before the Committee special mention must be made of the scheme put forward by A. M. Lindsay, Deputy Secretary and Treasurer of the Bank of Bengal. The importance of this scheme is due to its close resemblance to the plan which was in fact introduced later on. It suggested the raising in London of a long-period loan of £10 millions to be kept there as the Gold Standard Reserve. The arrangement of 1893 was intended to prevent the rise of the rupee above 1*s.* 4*d.* by making it binding on the Government to give rupees in exchange for gold or gold sovereigns. Lindsay's aim was to supplement this

[1] In 1894 the average exchange value of the rupee was 1*s.* 1½*d.* By 1898 it had risen to nearly 1*s.* 4*d.*

plan by making arrangements to give sterling in exchange for rupees so as to prevent the fall of the rupee below 1*s.* 4*d.* It was therefore proposed that the Government of India should sell in India sterling drafts on London for not less than £1,000 at the rate of 1*s.* $3\frac{3}{4}$*d.* per rupee, which were to be met from the reserve in London.

In London, rupee drafts were to be sold to applicants for not less than Rs. 15,000 at the rate of 1*s.* $4\frac{1}{16}$*d.* per rupee, and these were to be met at Calcutta and Bombay. If an excess of rupees accumulated in India as the result of selling sterling drafts, and consequently the reserve in London was unduly depleted, the excess of rupees was to be sold as bullion and the proceeds credited to the reserve in London. If, however, the stock of rupees in India was inadequate, silver was to be purchased out of the gold reserve in London and sent to India to be coined into rupees. The essence of this plan was that the rupee was to be the circulating medium in India, and gold was not to be legal tender. The Fowler Committee turned down the scheme, as they feared that its adoption would check that flow of capital to India upon which her economic prosperity so largely depended, and they objected that, if the system was made permanent in India, it would base India's gold standard for all time on a few millions of gold in London, with a liability to pay in terms of gold in London for rupees received in India to an indefinite extent.

The Fowler Committee concluded that the ideal to be aimed at was the 'effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold', and with this end in view made the following proposals: (i) The Indian mints should be thrown open to the coinage of gold sovereigns and half-sovereigns. The mints should remain closed to the free coinage of silver as already decided in 1893, 'until the proportion of the gold in the currency is found to exceed the requirements of the public'. (ii) The exchange rate was to be finally fixed at 1*s.* 4*d.* per rupee, as this was the rate that had already been established, and, prices having been adjusted to it, it would be easier to maintain than any other ratio. (iii) The rupee might continue to be unlimited legal tender. (iv) The Government should continue to give rupees in exchange for gold, though they should not bind themselves to give gold in exchange for rupees, because the undertaking of such an obligation would be inconvenient and make them liable to sudden demands for gold, to meet which it might sometimes be necessary to raise sterling loans at heavy cost. (v) To secure the convertibility of rupees into sovereigns, the profits on any future silver coinage undertaken by the Government should be credited to a gold fund to be kept 'as a special reserve, entirely apart from the Paper Currency Reserve and the ordinary treasury balances'. For although no legal obligation to convert rupees into gold was to be imposed on the Government, it would be an advantage if they could pay out gold when their reserves permitted and the people were willing to accept it. (vi) The Government should be prepared to make gold available, particularly for export when the balance of trade went against India. The Committee expected this gold to come from the gold reserves generally and especially from the gold fund proposed by it, but eventually also from circulation, which would become saturated with a large amount of gold as the result of the full introduction of a gold standard and gold currency.

In short, the Fowler Committee held that a fixed exchange could only be secured and guaranteed by an effective gold standard. The Committee accepted as their model the limping standard adopted by the Latin Union and the United States, under which both gold and silver were unlimited legal tender with a fixed legal ratio, and mints were open only to the free coinage of gold. The recommendations of the Fowler Committee were accepted almost entirely by the Government of India, and the Act of the year 1899 made sovereigns and half-sovereigns legal tender throughout India at the ratio recommended by the Fowler Committee. Negotiations were also set on foot for starting a gold mint in India, but they proved abortive on account of the opposition of the British Treasury. A Gold Standard Reserve was formed in 1900 out of the profits of the coinage of rupees on Government account, which was resumed for the first time after 1893.

§12. **Remedies adopted in relief of monetary stringency**—(i) *Circulation of gold.*—After the above action had been taken in faithful compliance with the Fowler Committee's recommendations, Government policy soon broke loose from its moorings and drifted aimlessly until it landed into the patchwork of improvizations called the Gold Exchange Standard. The closing of the mints had resulted in a stringency which was felt keenly as trade expanded and population increased. As a temporary measure for meeting the situation, Act II of 1898 had already been passed, by which 'the proceeds of the Secretary of State's sales of Council Bills could be set aside at the Bank of England in gold as part of the Indian Paper Currency Reserve. The Government of India could issue notes against the gold so set aside, and with them could meet *pro tanto* the Secretary of State's drafts, without reducing their treasury balances'.[1] This had the effect of adding to the drain on the stock of rupees with the Government of India. In order both to familiarize the people with gold coin and to obviate the necessity of fresh coinage of rupees, the Government made an active attempt in 1899 and 1900 to introduce sovereigns into circulation by instructing post offices, paper currency offices, district treasuries and railways to encourage receipts and payments in the form of gold coin. Many of the gold coins thus issued, however, were soon returned to the Government who chose, rather too readily, to regard this as a failure of the experiment to induce people to use sovereigns as the medium of exchange.

(ii) *Issue of notes and rupees.*—However that may be, the Government felt themselves forced to resume coinage on a large scale in 1900. The silver required for this purpose was purchased with the gold in the Paper Currency Reserve in London. Act II of 1898 referred to above was intended to be purely temporary, and provided that the gold obtained by the sale of Council Bills and set apart in the Paper Currency Chest, was to be held by the Secretary of State in London, 'until he shall transmit the same to India, or until the Government of India shall appropriate and set apart in India as a part of the Currency Reserve an amount of

[1] As Kemmerer points out, this measure was practically an adoption of the Lindsay Plan by the Government (only however to reject it a year afterwards on the recommendation of the Fowler Committee). For it meant 'the sale of exchange in London by the Secretary of State on the Paper Currency Reserve in India [at rates representing practically the gold-export point for London, with the primary object of realizing currency to meet monetary demands in India]'. Kemmerer, op. cit., p. 102.

coin of the Government of India equal in value to the notes issued against the receipts from the sale of the Council Bills'. This Act was extended in the first instance to two and a half years, and again by two years in 1900, when the Secretary of State was authorized to use the gold so received by him for the purchase of silver bullion to be sent to India to be coined into rupees, and to treat such bullion in transit and in process of coinage as part of the Paper Currency Reserve. The Reserve in London was thus made to serve three distinct purposes. (*a*) It provided funds in London for the purchase of silver for coinage whenever necessary. (*b*) It could be used to support the Indian exchange, whenever India had an unfavourable balance of trade and it was impossible or disadvantageous to sell Council Bills. The Secretary of State would, in these circumstances, use the gold in the Paper Currency Reserve to meet his expenses and an equivalent amount would be transferred to the Paper Currency Reserve in India.[1] (*c*) And lastly, it was a fund into which payments might be made by the Secretary of State whenever he sold Council Bills in excess of his requirements in order to prevent exchange from rising unduly high and inducing an undesirable shipment of gold to India. Against these payments notes would be issued in India.

In 1902 these provisions were made permanent. In 1905, £5 millions, that had accumulated in the Reserve in India, were shipped to London to be held in the Paper Currency Chest of earmarked gold (not to be used for ordinary expenses) at the Bank of England, and a stated part of the Currency Reserve was invested in sterling securities. Since 1906 a substantial part of the Paper Currency Reserve came to be maintained in the form of gold.

§13. **The Gold Standard Reserve.**—In the year 1900, the Government of India proposed the constitution of a Gold Reserve to be kept in India as desired by the Fowler Committee. They proposed further that the Paper Currency Reserve should gradually revert to its original position and should be used only for the encashment of currency notes and further that it should consist principally of rupees and securities. The Gold Reserve, on the other hand, should consist chiefly of gold. The Secretary of State, however, decided against this. He preferred to have the gold located in London and invested in sterling securities. He held that, since London was the place in which the Reserve would have to be applied on the occasion of the emergency against which it was being created, London would be the best place in which to keep it. In this manner, instead of being used primarily as a gold redemption fund and for the maintenance of the exchange parity of the rupee, the Gold Reserve came to be regarded merely as part of the total surplus Government funds and as a kind of 'secondary reserve'. The work of maintaining the parity of the rupee fell chiefly on the Paper Currency Reserve and the sale of Council Bills in London, 'with the result that the three funds, namely, the Paper Currency Reserve, the Gold Reserve, and the Secretary of State's balances, soon found their functions confused, the properly fiscal function of the last fund and the properly monetary function of the other two being sadly mixed'.

According to the plan insisted upon by the Secretary of State, the profits from the coinage of rupees were remitted to London for investment, and this was effected by gold being withdrawn from the Paper Currency Reserve in London in

[1] See §14.

exchange for the fresh rupees coined in India. In 1906 the difficulty in meeting the demand for rupees led to the formation in India of a special Rupee Reserve outside the Paper Currency Reserve, called the Silver Branch of the Gold Standard Reserve.[1] The Rupee Reserve was intended to prevent the exchange from rising above 1*s.* 4*d.*, which necessitated the keeping open of an unlimited offer of rupees in exchange for sovereigns at this rate in India. The Notification of 1893 which had authorized the issue of rupees or notes against the tender of gold as distinguished from the British gold coin was withdrawn. In the meanwhile, the practice of shipping to London gold accumulated in the various reserves in India was found to be needlessly expensive, and, therefore, the practice of selling Council Drafts was extended beyond its original purpose after the year 1904, when the Secretary of State announced his intention of offering Council Bills for sale without limit of amount at the price of 1*s.* 4⅛*d.* If the cash balances in India were inadequate for this purpose, the demand was to be met by withdrawing rupees from the Paper Currency Reserve in India, an equivalent amount of gold being credited to the Paper Currency Chest in London. The price of 1*s.* 4⅛*d.* not being found prohibitive at all times of the export of sovereigns to India, which accumulated with the Indian Government, it was decided to offer Telegraphic Transfers against sovereigns in transit from Egypt and Australia to India, the rate for the Transfers being between 1*s.* 4*d.* and 1*s.* 4$\frac{1}{32}$*d.* (that is, lower than that for the Council Bills),[2] so as to make it worth the while of the owner of such sovereigns to divert them from India to London.

In June 1907, the Mackay Committee on Indian Railway Finance recommended that one million sovereigns out of the profits on the coinage of rupees in 1907 should be spent on railways. The Secretary of State went beyond the Committee and decided to spend on railways in the future one-half of any profit on the coinage of rupees, until the Gold Standard Reserve reached £20 millions, apparently contemplating the diversion of the whole of the profits to the railways after the maximum had been reached. The Government of India telegraphed to the Secretary of State that the portion of the Gold Standard Reserve in the form of sterling securities should be allowed to accumulate up to £20 millions before any such diversion was effected. The Secretary of State, disapproving, adhered to his decision, which, however, he had to reverse completely in 1909, owing to the exchange crisis of 1907-8.

§14. **The crisis of 1907-8.**—On account of a partial failure of crops in some parts and the outbreak of actual famine in others, Indian exports declined. In Europe also, after a period of prosperity, which reached its culmination in 1907, a decline set in, leading to unemployment and slack business. The purchasing capacity of Europe was thus impaired and the situation was aggravated by the general monetary stringency caused by a financial crisis in New York. While Indian exports of jute, wheat, cotton, etc., fell off, the imports rose, at least in the case of one commodity, namely silver, owing to a heavy fall in its price. All these factors contributed to the weakening of the Indian exchange. The stock of sovereigns began to

[1] The Gold Reserve came to be known as the Gold Standard Reserve from this date.

[2] For a detailed explanation of the working of this system, see J. M. Keynes, *Indian Currency and Finance*, pp. 114-18.

diminish rapidly, and the Exchange Banks urged the sale of Telegraphic Transfers on London. This was refused by the Government who, however, gave gold on certain conditions (not more than £10,000 to any one individual on any one day) from the Paper Currency Reserve. The situation growing worse; the Secretary of State advised the Government to offer Telegraphic Transfers or Reserve Councils on London at the rate of 1*s*. 3 29/32*d*. per rupee, and himself released gold from the Paper Currency Reserve in London, against a transfer of rupees to it from the treasuries in India. He had also to float a sterling loan of £4½ millions to keep up his finances, as no Council Bills could then be sold. He met the demand for the encashment of the Reserve Councils by selling the sterling securities in the Gold Standard Reserve in the market, even though they had depreciated in value. These measures brought about an improvement, and next year exchange was steady at 1*s*. 4*d*., the revival of the export trade from India coming to the rescue.

§15. **Gold Standard or Gold Exchange Standard?**—In meeting the crisis the Government had taken certain steps in a somewhat subconscious and tentative manner in the direction of the Gold Exchange Standard. Gold was at first given freely in exchange for rupees for internal use, whereas considerable reluctance was displayed in providing gold for private export abroad. This showed that the Government had not yet clearly thought out and definitely adopted the Gold Exchange Standard system. But the subsequent sale of Reserve Councils established a precedent, which brought the Indian currency system appreciably nearer the Lindsay Plan. The practice of paying out rupees and notes in India against deposits of gold in the Paper Currency Reserve in London had already been in vogue for some time, and in 1904 the Secretary of State had declared his willingness to keep the tap turned on indefinitely and sell the Council Bills to an unlimited amount at a fixed rate. In 1907-8 the sale of Reserve Councils, providing for the conversion of rupees into sterling for international purposes, may be said to have put the coping-stone to the edifice of the Gold Exchange Standard.

All the same, however, the Government of India had not yet formally accepted the whole gospel of the Gold Exchange Standard, and for some time after the crisis of 1907-8 we find them occupied in putting forward proposals which diverged in important particulars from the Gold Exchange Standard system as it came to be established eventually. For example they had not yet reconciled themselves completely to the location of the Gold Reserve in London and had not quite made up their mind about preventing the circulation of gold as a currency medium in India.

The steps taken in order to meet the crisis had resulted in a serious depletion of the Government's gold resources. In London, the sovereigns in the Currency Chest were reduced from £7 millions to £1½ millions, while in India the whole stock of gold was exhausted.[1] The Government were thus impressed with the necessity of enlarging the Gold Reserve so as to enable them to meet such crises with greater equanimity in the future. In 1909, they proposed to the Secretary of State that £25 millions should be regarded as the minimum necessary for safety, and that, until this figure was reached, no portion of it should be diverted for capital expenditure on railways. They also recommended that the Gold Standard Reserve should be maintained in a more liquid form.

[1] See H. F. Howard, *India and the Gold Standard*, p. 35.

The Secretary of State replied that £25 millions both in the Gold Standard Reserve and the Paper Currency Reserve together would, in his judgement, be the proper standard, and that so long as this combined total was not reached, no diversions would be made from the Gold Standard Reserve, and that the question might be reconsidered thereafter.

He did not wholly agree to the other proposal about maintaining the Reserve in a liquid form, but decided to keep £1 million of the Gold Standard Reserve liquid by allowing this amount to be lent for short periods on approved securities to approved borrowers in London, and to invest the rest in high-class securities with a near date of redemption, or in Consols and other approved stock.

In 1912, in deference to the wishes of the Government of India and in view of public criticism in India, the Secretary of State decided that £25 millions should be the standard for the Gold Standard Reserve, and that £5 millions in gold should be earmarked as deposit in the Bank of England.[1]

In taking the various steps described above, the Government had almost in spite of themselves steadily deviated from the straight and narrow path of the gold standard recommended by the Fowler Committee, and by a succession of opportunist measures were finally led into the scheme propounded by Lindsay. The system as it developed had not been thought of in 1893 and was opposed by both the Government and the Fowler Committee in 1899, nor is it possible to point to any single date at which it may be said to have been deliberately adopted.

Proposals for gold coinage and a gold mint were revived at the instance of the late Sir Vithaldas Thackersey, who moved a resolution to that effect in 1912 in the Imperial Legislative Council. Negotiations in this connexion lasted for about a year, when it was decided to refer this question along with others to a Currency Commission which was contemplated.

§16. **The mechanism of the Gold Exchange Standard.**—The late Lord Keynes, one of the ablest exponents of the system, the evolution of which has been traced above, and which remained in full operation from 1898-9 to 1915-16, summarized and explained its main features as follows. '(1) The rupee is unlimited legal tender and, so far as the law provides, inconvertible. (2) The sovereign is unlimited legal tender at £1 to 15 rupees and is convertible at this rate, so long as the Notification issued in 1893 is not withdrawn, i.e. the Government can be required to give 15 rupees in exchange for £1. (3) As a matter of administrative practice, the Government are, as a rule, willing to give sovereigns for rupees at this rate; but the practice is sometimes suspended and large quantities of gold cannot always be obtained in India by tendering rupees. (4) As a matter of administrative practice, the Government will sell in Calcutta, in return for rupees tendered there, bills payable in London at a rate not more unfavourable than 1*s*. 3 29/32*d*. per rupee.

'The fourth of these provisions is the vital one for supporting the sterling value of the rupee; and although the Government have given no binding undertaking to maintain it, a failure to do so might fairly be held to involve an utter breakdown of their system.

'Thus the second provision prevents the sterling value of the rupee from

[1] See Shirras, op. cit., p. 215.

rising above 1*s.* 4*d.* by more than the cost of remitting sovereigns to India, and the fourth provision prevents it from falling below 1*s.* 3 29/32*d.* This means in practice that the extreme limits of variation of the sterling value of the rupee are 1*s.* 4⅛*d.* and 1*s.* 3 29/32*d.*'[1]

It was claimed for the Gold Exchange Standard that, while it was much cheaper than a gold standard and a gold currency, it ensured all the advantages of the latter. In India it is obvious that the principal object of the system was the maintenance of the rupee at par with gold. When exchange showed signs of weakness, the Government were expected to come out as sellers of sterling (Reverse Councils), and when the rupee was tending to appreciate, to come out as sellers of the local currency (Council Bills). And the effectiveness of such Government interference depended upon the adequacy of the gold and rupee reserves.

§17. **Council Drafts system.**—The system of Reverse Councils and Council Bills was an important part of the Gold Exchange Standard system during the period up to 1914. But the Government had never bound themselves by law to sell Reverse Councils or sterling bills, and, moreover, occasions for selling them were comparatively rare. But, as we have already seen, the system of Council Drafts (Council Bills and Telegraphic Transfers) was the fly-wheel of the machinery for the management of Indian currency, exchange, and finance.

The practice of drawing funds from India by the sale of bills of exchange on India dated from the time of the East India Company.[2] Up to 1893, however, the sale of Council Drafts was, as a rule, limited by the actual requirements of the Secretary of State for meeting the Home Charges. The system enabled the Secretary of State to obtain funds at as favourable a rate as possible. It was also convenient to trade as providing a ready means of settling a large part of debts due to India from foreigners on account of India's surplus of exports over imports. In fact it was the existence of this surplus in normal times which made the system of Council Drafts possible and profitable.

For some years after 1893, a negative use, so to say, was made of the system for forcing up the exchange value of the rupee by a temporary cessation of the sale of Council Drafts. This had the effect of making the rupee less freely available and tended to raise its price in terms of sterling.

We have already seen how, in 1898, after the rupee had at last risen to 1*s.* 4*d.*, Act II of 1898 authorized the sale of Council Drafts against gold set aside at the Bank of England as part of the Indian Paper Currency Reserve, and notes of corresponding value were issued in India to meet the Council Drafts. The object was not merely to draw funds from India to meet the Home Charges, but quickly to expand the currency in times of monetary stringency in India, as an alternative to the shipment of sovereigns to India on private account, when the Government of India had no surplus treasury balances with which to meet Council Drafts.

[1] op. cit., pp. 6-7. Elsewhere (p. 20), Keynes described the essentials of the Gold Exchange Standard as 'the use of a local currency mainly not of gold, some degree of unwillingness to supply gold locally in exchange for the local currency, but a high degree of willingness to sell foreign exchange for payment in local currency at a certain maximum rate; and to use foreign credits in order to do this'.

[2] The following account is slightly abridged from the *Chamberlain Commission Report*, pars. 170-6.

A further step was taken when gold accumulated in London, and, representing the proceeds of the sale of Council Drafts against the issue of notes in India, was regarded as available for the purchase of silver for coinage in India. Since 1904, as already seen, an offer to sell Council Bills was kept standing. A similar train of events resulted in the issue by the Secretary of State, as occasion required, of notifications offering to sell Council Drafts against sovereigns in transit from Australia or Egypt to India, the motive being to avoid the expense and the waste involved in the shipment of sovereigns first to India and then to London for the purchase of silver, sovereigns beyond a particular limit not being required in India.

In 1909 and 1910, Council Drafts were freely sold to obtain gold in London in place of the large quantities of rupees, which had accumulated in the Gold Standard Reserve in India through the sale of Reverse Councils in London during the crisis. The effect of this was to bring the Gold Standard Reserve Fund back to London.

Profits on the mintage of rupees, which necessarily first took the form of rupees, were converted into sterling in London, the rupees which represented the profits being issued in India to meet the Council Drafts sold in London.

The consideration affecting Council Drafts[1] thus came to be very much wider than the mere question of putting the Secretary of State in funds for paying the Home Charges. To this purpose was added that of securing the convenience of trade and that of so manipulating the disposition and location of the resources of the Government as to give the fullest effect to Government policy in matters of currency, exchange and finance.

§18. **The Chamberlain Commission.**—In view of the persistent and severe criticism of the Government's currency and exchange policy, a Commission was appointed in April 1913 with Mr (later Sir) Austen Chamberlain as its Chairman, and it reported in February 1914. Its conclusions and recommendations were as follows:

(i) The establishment of the exchange value of the rupee on a stable basis was a matter of the first importance to India. (ii) The measures adopted for the maintenance of the exchange value of the rupee had been necessarily and rightly rather supplementary to, than in all respects directly in pursuance of, the recommendations of the Committee of 1898. (iii) The crisis of 1907-8 was the only occasion on which they had been severely tested, and they were found to work satisfactorily then. Owing to lack of experience in working the machinery and the absence of any plans fully worked out in advance for dealing with such a crisis, the Government did at first make mistakes. For example, the India Office seemed to believe that the sole, or at least the main, purpose of the Gold Standard Reserve was to meet the requirements of the Secretary of State in London, when Council Bills could not be sold, while the Government of India made the mistake of refusing to give gold from the Paper Currency Reserve for export, though allowing their gold to be drained away for internal use. Both the authorities failed to realize that the principal use of a gold reserve is that it should be freely available for foreign remittances whenever the exchange falls below specie point. These

[1] Replaced since 1923-4 by the system of purchase of sterling in India, which is discussed in the next chapter.

mistakes, however, were very quickly rectified in practice, and the steps taken to restore and maintain exchange proved adequate. (iv) The history of the previous fifteen years showed that gold currency in active circulation was not an essential condition of the gold standard, which had been firmly secured without this condition. (v) It would not be to India's advantage to encourage an increased use of gold in the internal circulation. (vi) The people of India neither desired nor needed any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consisted of rupees and notes. (vii) A mint for the coinage of gold was not needed for purposes of currency or exchange, but if Indian sentiment genuinely demanded it, and the Government of India were prepared to incur the expense, there was no objection in principle to its establishment either from the Indian or the Imperial standpoint, provided that the coin minted was the sovereign (or the half-sovereign); it was pre-eminently a question in which Indian sentiment should prevail. (viii) If a mint for the coinage of gold was not established, refined gold should be received at the Bombay mint in exchange for currency. (ix) The Government should aim at giving the people the form of currency which they demand, whether rupees, notes or gold, but the use of notes should be encouraged. (x) This internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling. (xi) No limit should be fixed to the amount up to which the Gold Standard Reserve was to be accumulated. Reliance ought to be placed on the Paper Currency Reserve for the support of exchange only in so far and so long as the Gold Standard Reserve was not adequate to support the burden by itself. (xii) The profits on the coinage of rupees should, for some time at least, continue to be credited exclusively to the Reserve. (xiii) A much larger proportion of the Reserve should be held in actual gold. By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about £10 millions in gold could at once be secured. This total should be raised, as opportunity offered, to £15 millions, and thereafter the authorities should aim at keeping one-half of the total Reserve in actual gold. While it was unnecessary and wasteful to hold the whole of the Gold Reserve in gold, the loss from enforced realization of securities in a time of crisis should be guarded against by maintaining a sufficient amount in liquid form. (xiv) The Indian branch of the Gold Standard Reserve should be abolished as it had given rise to much criticism, and was responsible for much confusion and doubt as to the efficiency of the Reserve. (xv) The proper place for the location of the whole of the Gold Standard Reserve was London. (xvi) The Government should definitely undertake to sell bills in India on London at the rate of 1*s*. 3 29/32*d*. per rupee whenever called upon to do so.[1]

The Commission thus gave its most unstinted approval to the nondescript currency system, which had been evolved more or less fortuitously. The Government had not always felt very comfortable under it, and responsible officials still spoke occasionally as if they regarded the Gold Exchange Standard, under which India found itself, as merely a wayside inn, the real destination being a gold standard with its usual accompaniment of a gold currency.[2]

[1] *Chamberlain Commission Report*, par. 223.

[2] Sir James Meston, speaking in the budget debate of 1910, used the following words:

In 1912, the Government of India, in sympathetic response to the agitation in the country in favour of a gold mint in Bombay which culminated in Sir Vithaldas's resolution referred to above, addressed the Secretary of State on the subject urging him not to turn a deaf ear to the popular demand for a gold coinage. The Chamberlain Commission, however, attempted to give a new turn altogether to the Government's thoughts. They practically assured them that, without knowing it, they had put India into the forefront of nations in currency matters by adopting the Gold Exchange Standard system.

Before the Government had had enough time to consider and give effect to the various recommendations of the Chamberlain Commission, the war of 1914-18 intervened and created an altogether novel set of conditions and raised new problems which we now proceed to discuss.

Effects of the War of 1914-18 on Indian Currency[1]

§19. **The first period (August 1914 to autumn 1915).**—The effects of the war may be considered under two main periods: (i) The first period extends from the outbreak of war in August 1914 to autumn 1915. This was a period of dislocation involving a general weakening of the currency, and exchange position.

(ii) The second period falls between autumn 1915 and the end of 1919. This may be considered as a period of revival and was characterized by great vigour in production. It witnessed a very large rise in the exchange and an unprecedented rise in the gold price of silver.

The outbreak of the war dealt a rude shock to public confidence and caused a general dislocation of trade and business. The principal symptoms of this were a weakening of the exchange, withdrawals of Savings Bank deposits, a demand for the encashment of notes, and a run on the Indian gold stocks.

The Government met the situation by prompt measures which helped the early restoration of confidence. The weakening of exchange was met by offering Reverse Councils, which were sold to the extent of about £8 millions up to February 1915, when the demand for Council Bills revived, and apart from short spells of weakness, Indian exchange remained strong throughout the second period, there being a very large demand for Council Bills, the whole of which could not be met.

A large amount—Rs. 6 crores out of a total of Rs. 24½ crores—was withdrawn from the Savings Bank deposits in the first two months of the war. The net withdrawals amounted to Rs. 8 crores, till the tide turned in 1915-16. The demands were freely met, and this proved useful in restoring confidence and attracting back

'We have linked India with the gold countries of the world. We have reached a gold exchange standard, which we are steadily developing and improving. The next and final step is a true gold currency. That, I have every hope, will come in time, but we cannot force it. The backwardness of our banking arrangements, the habits and suspicions of the people, the infancy of co-operation all stand in the way. But the final step will come when the country is ripe for it. I trust that it will not long be delayed; for when it comes, it will obliterate all the mistakes, all the inconveniences, all the artificialities, of our present position.'

[1] This account is largely based upon the *Report of the Babington Smith Committee*, 1921. The effects of World War II (1939-45) on Indian currency are reviewed in the next chapter.

the deposits, which again rose to Rs. 18 crores by the end of 1918-19 (i.e. Rs. 6½ crores less than the original amount).

The demand for the encashment of notes was also freely met, notes of the value of Rs. 10 crores being returned to the Treasuries up to March 1915. But from that time onwards there was a steady increase in the note circulation.

Lastly, there was a run on the Indian gold stock, which took the form of a keen demand for gold in exchange for notes. Precautions against the internal use of the gold so acquired proving useless, the issue of gold to private persons was altogether stopped, and notes were paid after that in silver coin only.

All these embarrassing symptoms disappeared by the end of the first period. The Government on the whole may be said to have faced the situation boldly and successfully. Public confidence was restored by the assurance given to the banking and commercial community of adequate and continuous facilities for remittance abroad and by the readiness with which the Government encashed currency notes as they were presented.

§20. **The second period (autumn 1915 to the end of 1919).**—After the first shock of the war had passed away, the currency mechanism worked smoothly for some time, and it was not till the end of 1916 that acute complications arose. There was a rapid rise in the price of silver and an increasing difficulty of obtaining it to meet the heavy demands for silver coins in India.

In the first place there was a heavy excess of exports over imports, and the balance of trade, which was at the outset of the war unfavourable to India, became now embarrassingly favourable. Although the export trade had at first suffered on account of the war, it made a steady recovery, thanks to the insistent demand for India's exports on the part of the Allies for the prosecution of the war. The import trade, on the other hand, suffered more, as we have already seen.[1] The result was that there remained a large excess of exports over imports to be liquidated.

To make the situation still more difficult, the Government of India had to incur heavy (recoverable) expenditure on behalf of His Majesty's Government. From 1914 to December 1919, £240 millions had to be so spent on military equipment in the eastern theatres of the war and to meet civil expenditure in occupied territory. In addition to this, arrangements had to be made for the financing of purchases in India, on behalf of some of the Dominions and Colonies and also for the African importers of Indian produce.

The combined effect of these factors was to create a heavy demand for Indian currency. The decrease in the imports of precious metals on account of the restrictions placed on their export by foreign Governments further added to the ticklishness of the situation. As the pre-war methods of liquidating the favourable balance were not available, the Government had to provide some sort of a substitute to prevent the paralysis of the export trade so vitally necessary for the successful prosecution of the war. They had, therefore, to sell Council Bills in London on a very large scale by way of providing means of remittance to pay for Indian exports. To meet these Bills it became necessary to undertake extensive coinage of rupees. This was a task which presented almost insuperable difficulties as various circumstances conspired to send up the price of silver to undreamt-of heights.

[1] Ch. vi, §5.

§21. **Rise in the price of silver.**—The principal factor which dominated the currency situation was the extraordinary rise in the price of silver. There was a great shortage of the supply of the white metal as compared with its pre-war level of production, owing to internal disturbances in Mexico and a great increase in its cost of production. On the other hand, there was an unusually keen world demand for the metal mainly for currency, on account of the shortage of gold and the almost universal anxiety on the part of belligerent and neutral Governments to conserve their supplies of it. The heaviest demand came from India and China. We have already seen that the burden of liquidating the favourable balance of trade and finding purchasing power for the expenditure on behalf of the British War Office was mainly thrown on the Government of India and took the form of large demands for the local currency, especially for rupees. The demand was further accentuated by the melting of rupees (notwithstanding its prohibition by law), when the intrinsic value of the coin exceeded its face value in the course of the great rise in the price of silver. Another factor which operated in the same direction was the influence of the dollar-sterling or the New York-London exchange. When in March 1919 the sterling-dollar exchange was decontrolled, it made a further move against England, reaching eventually as low a limit as \$3.40: £1 sterling.

Now the chief payment for silver purchased for India by the Secretary of State had to be made to America in terms of dollars, and the progressive depreciation of sterling raised the London sterling price and was bound to raise the rupee price of silver also, unless the rupee was given a correspondingly higher sterling value.

Having explained the causes of the rise of silver, let us now follow its meteoric flight. In 1915 the highest price of silver was 27 pence per ounce. In 1916, a maximum of 37 pence was reached. In August 1917, it exceeded 43 pence per ounce (which was the bullion par of the rupee, i.e. the price at which the exchange value of the rupee at 1*s*. 4*d*. was equivalent to its bullion or intrinsic value). In September 1917 the price rose to 55 pence. The United States, Great Britain and Canada, however, came to the rescue, all of them instituting a control over the trade in silver and prohibiting its export except under a licence and later on except at a specified price. These measures resulted in the price of silver being kept within the limits of 41 and 49 pence per ounce. But in May 1919, the United States and the United Kingdom withdrew this control and a further rise in the price of silver occurred. In the same month it reached 58 pence per ounce, after which it continued its upward career throughout the year, reaching the level of 78 pence in December. The highest point was attained in February 1920, when the London quotation rose to 89 pence per ounce.

§22. **Measures taken by the Government.**—(i) *Government control of exchange.*—After the country had lived down the first shock of the war, the demand for Council Bills revived with the revival of the export trade. It was fairly normal till October 1916, after which it rapidly increased owing to the rising favourable balance which, we saw, could not be liquidated by the normal method of free imports of specie. This resulted in the depletion of the rupee reserves in India, endangering the convertibility of the notes. In December 1916, therefore, restrictions were imposed on the sale of Council Bills, and the sale of Intermediate Councils was

stopped with the result that there was a divergence between the market rate of exchange and the Government rate. This was detrimental to the export trade, which it was essential to maintain uninterrupted for the successful conduct of the war. Therefore, certain measures of control were instituted by the Government, exchange being fixed at 1*s.* 4¼*d.* in January 1917. The sale of Council Bills was confined to some selected banks and firms, and these were required to do business with third parties at the prescribed rates, applying their resources mainly to certain selected articles of export of importance to the Allies. With the co-operation of the banks assisted by these control measures, further fluctuations in the exchange were prevented for some time.

(ii) *Raising of exchange rate.*—Very soon, however, it was found that these measures were not of substantial use in maintaining exchange stability owing to the remarkable rise in the price of silver. The Government could not go on selling rupees to the public at 16 pence when the cost of manufacturing a rupee became 18 pence, 20 pence and so on, with the successive rises in the price of silver. The Government did not entertain the suggestion made by some people in India that this loss should be debited to the Gold Standard Reserve, since it was meant for the very purpose of maintaining exchange stability. They denied that the Reserve was intended for such use and determined to shift this loss on to those who wanted rupees from them.

In pursuance of this policy, exchange was raised to 1*s.* 5*d.* in August 1917, and shortly afterwards the Secretary of State announced his intention to base the rates of exchange on the sterling price of silver, raising them as the latter rose.[1] The result is shown in the following figures.

Changes in the Rates of Exchange

Date	Exchange in Sterling	Date	Exchange in Sterling
3 January 1917 ..	1*s.* 4¼*d.*	12 August 1919 ..	1*s.* 10*d.*
28 August 1917 ..	1*s.* 5*d.*	15 September 1919 ..	2*s.* 0*d.*
12 April 1918	1*s.* 6*d.*	22 November 1919 ..	2*s.* 2*d.*
13 May 1919	1*s.* 8*d.*	12 December 1919 ..	2*s.* 4*d.*

The market rate and, later on, the rates for the sale of the Reverse Councils when these were sold from February 1920 onwards, were in the period from January to March 1920, 2*s.* 6*d.*, 2*s.* 8*d.*, 2*s.* 10*d.* and 2*s.* 11*d.*, the highest rate being reached in the early months of 1920.

(iii) *Purchase of silver.*—Special measures had to be taken to increase the

[1] 'This announcement was equivalent to declaring the restoration of the silver standard in India like the one that was in existence before 1873. From 1873 to 1893, the measure of value in India was fluctuating with changes in the gold prices of silver. The gold price of 165 grains of silver at any moment was the measure of value for the exchange of goods in India. The same was true now in view of the conditions described above. . . .'—Vakil and Muranjan, *Currency and Prices in India*, p. 112.

supply of currency, silver being purchased for the purpose from February 1916. To remove competition from private purchasers in India, the Government prohibited the import of silver on private account from September 1917. In 1918, as the result of negotiations with the Government of the United States, the latter passed the Pittman Act which authorized the sale of the silver in the reserve. The Government of India thus purchased 200 million ounces of pure silver at 101½ cents per ounce fine.

(iv) *Conservation and economy of silver.*—Further measures were taken for the conservation and economy of silver. Currency legislation was passed in June 1917, prohibiting the melting and export of gold and silver coins. Notes of the denomination of Re. 1 and Rs. 2½ were issued in December 1917. In January 1918, for the first time, nickel coins of the denomination of 2 annas, 4 annas and 8 annas were issued and made legal tender up to one rupee. From June 1917, the Government acquired gold imported on private account at a price based on the sterling exchange value of the rupee, irrespective of the premium on gold. Notes were issued against gold so acquired, and gold mohurs and sovereigns were coined and issued as currency to supplement the silver currency. When the restrictions on the export of gold from America were removed in June 1919 and the gold markets of South Africa and Australia became free, more gold was imported into the country and acquired by the Government. To encourage its import, they raised the acquisition price so as to include the premium on gold as compared with sterling. Gold so obtained was sold to the public fortnightly from August 1919 with the object of lowering the premium on it.

(v) *Inflation of paper currency.*—Relief was also sought in an increase of the note issue without the usual metallic backing. Further, restrictions were placed on its convertibility, such as suspension of the extra-legal facilities for conversion. Another remedy resorted to was a limitation of daily issues of rupees to single tenderers of notes.

(vi) *Financial measures.*—The ordinary and the capital expenditure were kept as low as possible, and additional taxation was imposed to increase the Government's purchasing power. Further, large rupee loans were floated in India bringing in Rs. 130 crores in three years (1917, 1918 and 1919), a phenomenal figure as compared with the pre-war figures and expectations. Short-term Treasury Bills of from three to twelve months' duration were also issued in considerable quantities from October 1917.

All these measures materially assisted the meeting of the heavy demands for remittances to India and the direct demands for currency there.

§23. **The Babington Smith Committee.**—The war had broken out while the recommendations of the Chamberlain Commission were still under consideration and, as we have just seen, the events of the war years had raised a crop of fresh problems and new difficulties. The Secretary of State, therefore, appointed on 30 May 1919 another expert committee under the presidency of Sir Henry Babington Smith.

As the Smith Committee remark: 'For the current operations of trade, stability [of exchange] is an important facility rather than an essential condition.' But the evils of instability are intensified if the movements of exchange are brought

about not by economic causes, but by administrative acts. The possibility of official intervention makes it difficult for the commercial community to provide against the risks of fluctuation. Stability of exchange, therefore, is particularly important in an unautomatic currency system like that of India.

The question whether the exchange should be stabilized at the old level or somewhere near the new level which it had reached, was decided by the Committee in favour of the latter alternative, on the ground that it would shorten the period of uncertainty and prevent economic dislocation and social discontent. The following is a summary of the main recommendations of the Committee.[1]

(i) The rupee should remain unlimited legal tender. (ii) It should have a fixed exchange value which should be expressed in terms of gold at the rate of one rupee for 11·30016 grains of fine gold, i.e. one-tenth of the gold contents of the sovereign. (iii) The sovereign previously rated by law at fifteen rupees should be made legal tender in India at the revised ratio of ten rupees to one sovereign. (iv) The import and export of gold should be freed from Government control as soon as the change in the statutory rate to Rs. 10 had been effected, and a gold mint at Bombay should be opened for the coinage into sovereigns of gold tendered by the public. (v) The notification of the Government undertaking to give rupees for sovereigns should be withdrawn. (vi) The prohibition of the private import and export of silver should be removed and the import duty on silver should be repealed unless the fiscal position demanded its retention. (vii) The Gold Standard Reserve should contain a considerable proportion of gold and the aim should be to hold the remainder of the Reserve in securities issued by Governments within the British Empire (other than the Government of India) maturing within twelve months. A portion of the gold held in the Reserve, not exceeding one-half, should be held in India.

The recommendation to fix the exchange value of the rupee at 2*s*. gold was qualified by the following remark:

'If, contrary to expectation, a great and rapid fall in world prices were to take place and if the costs of production in India fail to adjust themselves with equal rapidity to the lower level of prices, then it might be necessary to consider the problem afresh.'

§24. **Government action on the Report.**[2]—The Government accepted the Committee's recommendations and took the following steps to put them into force:

(i) *Control of exchange.*—In January 1920 the demand for Council Drafts had ceased and a strong demand for Reverse Councils had set in. During January the drafts had been sold at a rate based on the rate of 2*s*. 4*d*., which had been fixed for the sale of Council Bills. But in compliance with the Committee's recommendation, the Government notified that Council Drafts and Telegraphic Transfers would be offered for sale weekly by competitive tender with no fixed

[1] The summary has been taken from Appendix 3 to the *Report of the Hilton-Young Commission on Indian Currency*, 1925-6, but the recommendations with regard to the constitution and location of the Paper Currency Reserve have been omitted here.

[2] See *Report of the Royal Commission on Indian Currency and Finance* (1925), vol. II, Appendix 3; also H. Stanley Jevons, *Money, Banking and Exchange in India*, ch. xv.

minimum rate; and that, in future, Reverse Drafts and Telegraphic Transfers would be offered in India, when occasion so required, at a rate based on the sterling equivalent of the price of 11·30016 grains of fine gold as measured by the prevailing sterling-dollar exchange, less a reduction representing the cost of remitting gold.

(ii) *Change in the legal tender value of the sovereign.*—The internal ratio of one sovereign for Rs. 10 could not be made effective so long as gold bullion continued to command a high premium over the price indicated by the ratio recommended by the Committee. We have already seen how, as far back as 1917, the Government had started the compulsory acquisition of gold imported on private account and how they had begun from September 1919 their series of fortnightly sales of gold with a view to reducing the premium on it. Gold, however, still commanded a high premium over the price recommended by the Smith Committee. In February 1920, the Government announced that, during the next six months, a minimum of 15 million tolas of fine gold would be sold; but this original programme was extended by further sales in August and September. After selling a large quantity at an average rate of Rs. 22 per tola, the gold sales were stopped in October 1920 and the price of gold, which had been controlled to some extent by the Government sales, again went up. This part of the Government's policy must therefore be pronounced a failure.

By Ordinance No. III of 21 June 1920, sovereigns and half-sovereigns ceased to be legal tender in payment or on account, but provision was made for their acceptance by the Government at the ratio of Rs. 15 during a moratorium of 21 days, on the expiry of which the restrictions on imports of British gold coin were also withdrawn. The sovereigns and half-sovereigns tendered at the currency offices and treasuries in the 21 days during which the moratorium continued amounted to about £2½ millions.

The Currency Committee's recommendation that the sovereign should be made legal tender in India at Rs. 10 instead of Rs. 15 was given effect to by the Indian Coinage (Amendment) Act, No. XXXVI of 1920. This Act restored the legal-tender character of the sovereign and half-sovereign which had been suspended by Ordinance No. III of 21 June 1920. The rate fixed by the new Act was Rs. 10 to the sovereign and instructions were accordingly issued to treasuries and currency offices that sovereigns and half-sovereigns, if presented, should be received at the rate of Rs. 10 and Rs. 5 respectively, but that they should not be issued. As the market price of the sovereign continued to be above Rs. 10, it never functioned as currency at the new ratio. It was therefore thought unnecessary to open a gold mint in Bombay.

(iii) *Abolition of war-time restrictions.*—In February 1920 the prohibition on the import of silver (but not on export) was removed, and also the import duty of four annas per ounce which had been levied was abolished. Similarly, the war-time notifications which had been issued prohibiting the use of gold and silver coin otherwise than as currency, or dealing in them at a premium, were also cancelled. The fall in the price of silver and the return of silver coin from circulation, which commenced in May 1920, made possible the abolition of the remaining war-time restrictions on the movements of precious metals. On 21 June the restrictions

on the import of gold bullion and foreign coin were removed. A few days later restrictions on the use of silver for making payments on behalf of the Government were withdrawn, and treasury officers were instructed that payments should in future be made in the form of currency desired by the payee. Steps were also taken in the direction of renewing the extra-legal facilities (for conversion of notes into rupees) which had been temporarily withdrawn. The treasury officers, for example, were instructed as far as possible to give silver in exchange for notes if presented in reasonably small quantities. In short, so far as silver was concerned, full effect was given to the recommendations of the Currency Committee before the end of 1920.

The measures taken with reference to the reconstitution of the Paper Currency Reserve will be referred to later on (§33).

§25. **Sale of Reverse Councils.**—We must now recount in greater detail the Government's attempt to maintain the new ratio of 2*s.* gold and the ghastly failure with which it met. On the date of the publication of the Smith Committee's Report the American cross-rate[1] had reached the low level of £ 1 : $3.65. It was obvious that the existing rate of the rupee-sterling exchange must rise very considerably, if the Government were determined to keep the value of the rupee at 2*s.* gold. Indian exporters in these circumstances were anxious to discount their export bills as quickly as possible in order to save themselves from the expected rise of exchange. But this rush of the exporters to turn their bills into rupees was itself bound to send up the sterling value of the rupee which, accordingly, rose to 2*s.* 8½*d.* within three days of the announcement of the 2*s.* gold ratio. Another fall in the American cross-rate caused a further rise in the rate of exchange, which stood at the unprecedented figure of 2*s.* 10½*d.* on 11 February 1920. After this, however, a reaction set in. The rush of the exporters to discount their bills had abated. The demand for sterling on the other hand became more and more intense owing to the Government's decision about the ratio. Commercial firms and private persons hastened to make their remittances to England, which in the ordinary course of things would have waited for several months, in order to take advantage of the abnormally high rate of exchange.

As a result of the huge profits made during the war of 1914-18 by certain sections of the people, there was a heavy boom of company flotations and this meant orders on an unusually large scale for foreign plant and machinery, of which the cost was remitted in advance in order to make the best of the high rate of exchange so long as it lasted. There was also a good deal of speculation in exchange, as it was easy to make handsome profits by the simple process of first turning rupees into sterling when the rate was high, and then translating sterling back into rupees when the exchange came down, as the speculator hoped and anticipated it would.

This heavy demand for sterling made for a rise in its value, that is, a fall in the value of the rupee. The divergence between the market and the official rate

[1] 'The rate of exchange between London and New York is spoken of in India as "the American cross-rate" or as the "New York cross-rate". A cross-rate is the rate of exchange between any two places outside of one's own country.'—Jevons, op. cit., p. 217 n.

which thus arose, and which at times amounted to as much as 3*d*. or 4*d*., further stimulated the demand for the Reverse Councils.

By far the most important cause, however, responsible for the sagging of the exchange was the tendency towards the adverse balance of trade referred to above as having commenced in January 1920. This tendency gathered momentum with every month that passed. The Government at first started selling Reverse Councils at rates based on 2*s*. 8*d*. sterling on 5 February. The rate was raised to 2*s*. $10\frac{27}{32}$*d*. on 12 February, but thereafter it decreased as sterling appreciated. By the end of June, the balance of trade had begun to turn strongly against India, with the result that the market rates of exchange had not merely departed from the parity of gold, but had fallen below the parity of 2*s*. sterling. After this the Government tried to maintain the rate at 2*s*. sterling. Consequently at the sale of 24 June and subsequent sales the rate adopted for Immediate Telegraphic Transfers was 1*s*. $11\frac{19}{32}$*d*. The reason advanced was that this represented the rate which would ultimately hold when sterling returned to parity with gold. But in reality it meant that the Government had given up hope of effecting the 2*s*. gold rate recommended by the Smith Committee, which thus had mounted, shone, evaporated and fallen—all within the brief space of less than six months. The market rate of exchange continued to fall without the Government being able to arrest its downward career. They were compelled to reduce their own rates following the market rate, and the only principle that was adopted was to keep the official rate at a somewhat higher level than the market rate. But this could not last indefinitely, and the Government finally abandoned their attempt to regulate the exchange. At the end of September 1920, the sales of Reverse Councils since the beginning of the year had amounted to £55,382,000. The Reverse Councils were paid in London out of the proceeds from the sale of sterling securities and Treasury Bills belonging to the Paper Currency Reserve. These securities and bills had been bought at the rate of Rs. 15 to the pound, but they were sold at rates ranging from Rs. 7 to Rs. 10. The difference between the selling and buying price measured an aggregate loss of Rs. 35 crores to the Indian exchequer.

Apart from the heavy losses suffered by the Indian exchequer in connexion with the sale of the Reverse Councils, the eventual collapse of the exchange was ruinous to business in more ways than one. A very considerable deflation of money had occurred as the result of the sale of the Reverse Councils. The note circulation between 1 February and 16 September 1920 had been reduced from Rs. 185 crores to Rs. 158 crores by the process of cancelling the notes received by the Government in payment for Reverse Councils. This very substantial withdrawal of currency had proved ineffective for maintaining exchange owing to the abnormal activity of the import trade and the absence of any support from exports. But it caused an acute monetary stringency, and was responsible for a fall in the level of prices. Both these circumstances together greatly enhanced the difficulties of business men, who were compelled to sell off their stocks at ruinously low prices.

The heaviest loss, however, was due to the fact that the commercial community had relied on the Government maintaining the exchange at the high rate chosen by them. Goods had been ordered in the confident expectation that exchange

would remain high, but the exchange had fallen heavily by the time they arrived. This meant nothing less than bankruptcy to many importers whose reliance on Governmental ability to keep the exchange at the desired high level was so complete that they had failed to take the usual precaution of covering their exchange.

§26. **Government policy examined.**—All this, however, may fairly be taken as proving that many sagacious and hard-headed business men did not regard the maintenance of the high rate as an impossible task, whatever they may have thought about its advisability.

The Government themselves had no doubt in their mind about the practicability of maintaining the ratio at 2*s*. gold, being reassured on this point by the majority report of the Babington Smith Committee. It is true that Sir Dadiba Dalal in his able dissenting minute had argued strongly against the high ratio and dwelt at length on the evils sure to follow from it. But he does not seem to have laid any particular emphasis on the *impossibility* of maintaining the ratio for any length of time.

At the same time, it must be noted that when the Government set out to give effect to the recommendations of the Babington Smith Committee, there were several facts before them which might have given them pause in initiating such a revolutionary change in the currency standard. For example, in August 1920, when the altered ratio was to have come into effect, gold was selling at Rs. 23¼ per tola, whereas according to the new ratio the price of gold ought to have been Rs. 15-14-0. In view of such a great disparity it should have been clear that it would be extraordinarily difficult, if not impossible, to maintain the ratio of 2*s*. gold. Again, the price of silver itself had gone down to about 44*d*. per ounce and therefore the danger of rupees being melted down had practically disappeared. Moreover, even if a certain amount of melting had taken place, this would not have mattered much considering the vast volume of rupees in circulation.[1]

The Babington Smith Committee had entirely misread the situation when they put the rise of silver in the forefront of causes explaining the rise in the Indian exchange. The most important cause of the rise in the sterling value of the rupee was the greater rise in sterling prices as compared to the rise in rupee prices. According to the Purchasing Power Parity doctrine, the rate of exchange had to move up in sympathy so as to bring about equilibrium.[2] The 2*s*. gold rate meant a considerable overvaluation of the rupee in comparison with its purchasing power parity with gold at the time, and the attempt to give a fixed gold value to the rupee was premature, as the value of gold itself was undergoing the most violent variations and the conditions of international trade were still extremely unstable.[3]

[1] See Ambedkar, op. cit., p. 207.

[2] 'The rise in the price of silver was really a mere coincidence due to a large extent to speculation. In ignoring the significance of the rapidly altering price-levels and fixing its attention merely upon the speculative prices of silver, lay the fundamental error of the Smith Committee's Report on Indian Currency. In linking the rupee to gold at 2*s*., it overlooked the real character of the rise which had taken place and underestimated the deflation which would have become necessary to maintain that rate. Its surmises regarding the probable course of prices in other countries were perhaps the most ridiculous examples of economic prophecy to be met with in history.'—Vakil and Muranjan, op. cit., pp. 340-1.

[3] See Gustav Cassel's Memorandum, *Hilton-Young Commission Report*, vol. III, Appendix 92.

The high price of silver was partly the result of the depreciation of the rupee as well as of sterling in terms of commodities in general. Even supposing, however, that the rise in the price of silver had been the chief cause of the rise in the exchange, the former was largely speculative. The tremendous range of variation in its prices should have served as a warning that the rise was without an element of permanence and stability.

The gravamen of the charge against the Government was not so much that they shaped their policy in the beginning in accordance with the advice of an expert Committee, but that having seen the palpable futility of the efforts to make the 2*s*. gold rate effective, they still persisted in the sale of Reverse Councils. By the end of June 1920, it was fairly clear that the task which the Government had taken upon themselves was an impossible one, and it would have been a courageous and wise step frankly to have acknowledged defeat at an early stage. As it was, however, they persevered in their ill-advised attempt to bolster up the exchange, dissipating their huge gold resources in the process and causing tremendous disturbance in the industrial and commercial world. Thus, as Sir Stanley Reed put it, 'a policy which was avowedly adopted to secure fixity of exchange produced the greatest fluctuations in the exchanges of a solvent country and widespread disturbance of trade, heavy losses to the Government, and brought hundreds of big traders to the verge of bankruptcy'.[1]

§27. **The policy of masterly inactivity (1921-5).**—After the failure of the attempt to stabilize exchange, the Government had to be content for some time with watching, in a spirit of patient expectancy, the course of events as they unfolded themselves, without taking any decisive action.

In the year 1921, the balance of trade was still against India. The depressed condition of the export trade was due to a rapid fall of world prices in terms of gold and the still more rapid fall of sterling prices owing to the steps taken by England to bring sterling back to gold parity. Under these circumstances, the expected happened and the sterling value of the rupee fell steadily. In the course of the year 1921, the Government had contracted the currency to the extent of Rs. 31,58,000. This, however, was not enough to arrest the downward course of exchange, which was driven to as low a level as 1*s*. 3*d*. The contraction of currency was continued further in 1921-2 and 1922-3 by the transfer of sterling securities held in London to the Secretary of State's cash balance and by the discharge of Indian Treasury Bills held in the reserve. With a view to preventing the further fall of the rupee the Secretary of State had also discontinued the sale of Council Drafts.

In 1922-3 the export trade of India showed a revival owing to good harvests and an improvement in the purchasing capacity of the European countries. The joint result of the contraction of currency and the revival of exports was to raise the exchange value of the rupee slowly but steadily. In September 1923 the rupee was equivalent to about 1*s*. 3⅞*d*. gold, and the pre-war ratio of 1*s*. 4*d*. could have been easily restored without adversely affecting any interest whatsoever, as was unsuccessfully urged by the Indian Merchants' Chamber. The Government, however, were apparently trying to take the ratio up to 1*s*. 6*d*., and the rupee as a

[1] Quoted by B. E. Dadachanji, *History of Indian Currency and Exchange*, p. 137.

matter of fact reached the level of 1*s.* 6*d.* sterling in October 1924. The Government's action after this was directed towards preventing the rise of the rupee much beyond this point. In order to achieve this result, the method of purchase of sterling required for Government remittances and, when necessary, in excess of this requirement, was freely used, and fresh currency was issued against these purchases, thus incidentally relieving to some extent the monetary stringency occasioned by the Government policy of deflation. The exchange value of the rupee reached 1*s.* 6*d.* gold in April 1925, and remained—or, as the critics of Government put it, was held—there until 21 September 1931.[1]

The end of the policy of masterly inactivity was now in sight. The Government of India in response to repeated requests from various quarters promised an inquiry into the currency situation early in 1925 through an authoritative committee before the end of the year, by which time they anticipated that the world conditions would become sufficiently stable: On 25 August 1925 a Royal Commission on Indian Currency and Exchange was appointed under the presidency of Lt-Commander Hilton-Young.

Before considering the deliberations and decisions of the Commission we shall turn aside to give an account of the evolution of the Indian Paper Currency system.

Indian Paper Currency

§28. **Early history.**—Under the Acts of 1809, 1840 and 1843 the Presidency Banks of Bengal, Bombay and Madras were authorized to issue notes payable to bearer on demand subject to certain regulations as to maximum issue and reserves. But their circulation was restricted within narrow bounds, being practically confined to the three Presidency towns. In 1860, James Wilson, the first Finance Member of India, worked out a scheme for a Government Paper Currency and the abolition of the right of note-issue enjoyed by the Presidency Banks. Sir Charles Wood, the then Secretary of State for India, laid down the following principles on the lines of the English Bank Charter Act of 1844:

The function of note-issue should be entirely separated from that of banking, as was also suggested by Wilson, and, second, as Sir Charles Wood put it, 'the amount of notes issued on Government securities should be maintained at a fixed sum, within the limit of the smallest amount which experience has proved to be necessary for the monetary transactions of the country, and that any further amount of notes should be issued on coin or bullion'.[2] Accordingly, the Paper Currency Act of 1861 was passed. The country was at first divided into three circles of issue, with headquarters at Calcutta, Bombay and Madras. The number of circles subsequently grew, and settled down to seven in 1910, the four additional circles being Rangoon, Karachi, Cawnpore and Lahore. Notes were issued of the denominations Rs. 10, 20, 50, 100, 500, 1,000 and 10,000. Notes of a smaller denomination, viz. the five-rupee note, were introduced in 1891. They were to be issued to the public without limit in exchange for rupees or British gold coins, and in exchange for gold bullion on the requisition of the Controller of Currency. They were declared unlimited legal tender both at the Government Treasuries and in private transactions, but only within their respective circle of issue.

[1] See ch. ix.

[2] See Keynes, op. cit., p. 39.

A reserve was formed in bullion and coin to the full value of the notes issued with the exception of a small portion invested in the Government of India Rupee Securities as a guarantee of their convertibility.

The notes could be encashed as of right only at the head office of the circle of issue. At the same time Government Treasuries cashed notes of other circles for bona-fide travellers and for the railway companies. Payment of Government dues could be made in the currency notes of any circle.

§29. **Restrictions as to encashment and legal tender.**—India is a vast country, and the conditions of trade cause large movements of money from one part to another at different times of the year. The first use of notes would therefore be for remittance in a more convenient way than by sending specie. The Government would have been obliged to send cash from place to place if they had not restricted the legal tender quality of the notes to the circle of issue. If, on the other hand, the notes had been made universal legal tender but only encashable at Presidency towns, there would undoubtedly have been a premium on coin at certain times of the year which would have impaired the popularity of the notes.

The circle system, however, greatly restricted the normal expansion and popularity of notes, and the first step was therefore taken in 1903 to abolish it when the five-rupee note was made universal legal tender except in Burma, this restriction being removed in 1909. In 1910, notes of the denominations Rs. 10 and Rs. 50 were similarly universalized, and power was taken to universalize notes of higher denominations by executive order. In 1911 accordingly, the Rs. 100-note was universalized. The Chamberlain Commission recommended the universalization of the Rs. 500-note also. This process of universalization led to a rapid expansion of the total circulation of notes. Extra-legal facilities for encashment of notes had been provided at the Government Treasuries in various places, and the Presidency Banks undertook further to extend such facilities at their head offices and branches. The period of the war of 1914-18 arrested any further development in this direction, as there were difficulties in getting enough rupees coined and the uncovered note issue also increased. The Babington Smith Committee recommended the abolition of war-time restrictions and further extension of extra-legal facilities for the encashment of notes as essential for making them more popular and accordingly they have been revived. The Rs. 500- and Rs. 1,000-notes were made universal legal tender during 1931-2.[1]

§30. **Paper Currency Reserve.**—The Act of 1861 provided for a fixed maximum fiduciary issue in the form of Government securities up to Rs. 4 crores. The limit was changed from time to time by special Acts: to Rs. 6 crores in 1871; in 1890 to Rs. 8 crores; in 1897 to Rs. 10 crores; and in 1905 to Rs. 12 crores. Up to this time the securities were the rupee securities of the Government of India held in India, but the Act of 1905 authorized the holding of sterling securities in England up to Rs. 2 crores. Since 1905, part of the invested portion of the reserve thus came to be held in the form of sterling securities.[2] In 1911, the maximum

[1] *Report of the Controller of Currency* (1931-2), par. 60. Notes of denominations higher than Rs. 100 were demonetized in 1947 by Government ordinance.

[2] *Ante*, §12, last para.

reserve in securities was fixed at Rs. 14 crores, of which Rs. 4 crores were to be in sterling securities.

As already pointed out, up to 1898 the whole of the Paper Currency Reserve, except a fixed fiduciary portion, was held in silver coin in India. In 1898, the Gold Note Act authorized the Government to hold any part of the metallic portion of the reserve in gold coin. The Act of 1900 gave authority to hold part of this gold coin in London. The Act of 1905 gave the Government full power to hold the metallic portion of the reserve, or any part of it, either in London or in India, and in gold coin or bullion, or in rupees or silver bullion, with the proviso that all coined rupees were to be held in India only.

As pointed out above, except for a fixed maximum fiduciary issue, which was raised from time to time, the whole of the rest was held either in gold and silver bullion or coin. With the gradual expansion of the note issue, an ever-diminishing proportion came to be invested as a result of this practice. On the other hand, a growing proportion came to be held in liquid form, sometimes as much as 80 to 85 per cent. This was due to a deliberate change of policy and to the use of the liquid part of the reserve for a new purpose, namely, that of supporting exchange whenever necessary. In fact, as we have already seen, this was considered as the first line of defence of the currency system as a whole.

The result of the policy was that a superlatively safe reserve was held for ensuring the convertibility of the notes, but at the cost of economy. This could have been avoided by increasing the invested portion, the best way of doing which was to make cash bear a certain percentage of or proportion to the total issue of notes. In this way also the frequent resort to legislation to raise the fiduciary limit could have been avoided.

§31. **Composition of the Paper Currency Reserve criticized.**—The main criticism against the composition of the Paper Currency Reserve before 1914 was against (i) the unduly large metallic reserve; (ii) the impossibility of increasing the fixed fiduciary reserve except by special resort to legislation; and (iii) investment of part of the Paper Currency Reserve in sterling securities in England.

(i) and (ii) made the system generally inelastic. As regards (iii), the practice was sought to be justified on the ground that the sterling securities were useful for maintaining the exchange value of the rupee and that they possessed the additional advantage of not being liable to depreciation in the event of an internal crisis in India. As against this it was argued that the maintenance of the exchange value of the rupee was not the proper function of the Paper Currency Reserve, that even sterling securities were liable to depreciation in the event of a crisis in England and that public confidence in the note issue could only be secured by holding the whole of the reserve in India.[1]

The function of note issue was entirely dissociated from the function of banking and there was nothing like a central bank and therefore no Government banker. There was the Reserve Treasury system, under which public funds were locked up in special Government Treasuries (except for small amounts confided to the Presidency Banks), bringing about a stringency in the money market during the busy season of the year.

[1] See next chapter for further criticism of the location of the Paper Currency Reserve.

The internal currency was absolutely inelastic for special and general purposes, and there was no provision for its temporary expansion except by importing funds from abroad either by the purchase of Council Bills or import of sovereigns. Similar defects had been overcome in other countries by the use of deposits and cheques, as in England and the United States, or by special temporary issue of paper currency against commercial bills of exchange, and lastly by placing Government funds at the disposal of a central bank.

The first method, namely that of cheques and deposits, is not even today much in use in India except at the few big commercial centres. The second was suggested by the Smith Committee and has been accepted. The third was also adopted by abolishing the Reserve Treasuries and placing the Government funds with the Imperial Bank of India which acted between 1921 and 1935 (before the inauguration of the Reserve Bank) as the Government bank. In order to remedy the general inelasticity the Smith Committee had suggested that the metallic portion should not fall below 40 per cent of the total issue although they held that it would be desirable to maintain a substantial margin above the statutory minimum, especially in the busy season. The fiduciary reserve would thus increase automatically with the increase of circulation without frequent resort to legislation. As we shall see later, the Government accepted the Smith Committee's suggestion in 1920, although they adopted a higher percentage for the metallic reserve, viz. 50 per cent.[1]

§32. **Effects of the war of 1914-18 on the paper currency.**—We saw above how, on the outbreak of war in 1914, there was at the outset a general feeling of panic which led to a severe run on the Paper Currency Office, followed, however, by a gradual revival of confidence and a steady increase in the note circulation. The effects of the war on the paper currency from March 1915 onwards may be summarized as follows:

(i) Inflation of paper currency caused by the great demand for currency, which could not all be met by a fresh issue of rupees. The causes of this abnormal demand have already been discussed. (ii) As the result of successive Acts the fiduciary reserve increased tremendously, as is shown by the following table:

In crores of rupees

Acts	Permanent investments	Permissible temporary investments	Total
Act VII of 1911 (pre-War)	14	..	14
Act V of 1915	14	6	20
Act IX of 1916	14	12	26
Act XI of 1917	14	36	50
Act XIX of 1917..	14	48	62
Act V of 1918	14	72	86
Act II of 1919	14	86	100
Act XXVI of 1919	20	100	120

These Acts were supplemented by Ordinances issued by the Governor-General. This striking expansion of the invested reserve was necessitated by the difficulty which the Government experienced in finding enough coin to be held in the

[1] See §33.

reserve. Also recoveries of the war expenditure in India incurred on behalf of England were made in London by the Secretary of State, and it being considered inadvisable in the Imperial interest to hold these proceeds in gold earmarked for the Paper Currency Reserve in London, the alternative of investing them in British Treasury Bills or short-term sterling securities was adopted,[1] although a part was invested in Indian Treasury Bills as well. (iii) The fall in the metallic reserve from 78·9 per cent in 1914 to 35·8 per cent in 1919. (iv) New notes of the low denominations Re. 1 and Rs. 2½ were issued in December 1917 and January 1918 respectively as a measure of economizing silver, apparently in imitation of the issue of £1 and 10*s.* notes in England in the war period. The public did not at first take kindly to them. But the one-rupee note made steady headway and its circulation on 31 March 1919 amounted to Rs. 10,50 lakhs as compared with Rs. 1,84 lakhs in the case of the other note.[2] (v) The abolition of extra-legal facilities[3] for encashment owing to the scarcity of rupees, the notes thus running to a discount of as much as nineteen per cent in some places—particularly the new notes of smaller denominations. (vi) The import of 200 million ounces of American silver released under the Pittman Act to meet the Paper Currency crisis of April 1918.

The subjoined table brings out clearly the effects of the war on the composition and location of the Paper Currency Reserve.[4]

In lakhs of rupees

Last day of March	Total note circulation	Composition and location of the Reserve							Percentage of securities to Total Reserve
		Silver	Gold			Securities (purchase price)			
		India	India	England	Total	India	England	Total	
1914 ..	66,12	20,53	22,44	9,15	31,59	10,00	4,00	14,00	21
1915 ..	61,63	32,34	7,64	7,65	15,29	10,00	4,00	14,00	23
1916 ..	67,73	23,57	12,24	11,92	24,16	10,00	10,00	20,00	29
1917 ..	86,37	19,21	12,00	6,67	18,67	10,00	38,49	48,49	56
1918 ..	99,79	10,79	26,85	67	27,52	10,00	51,48	61,48	62
1919 ..	153,46	37,39	17,37	12	17,49	16,08	82,50	98,58	65
1920 ..	174,52	39,80	..	..	47,70	..	..	86,86	50

§33. **Reconstitution of the Paper Currency Reserve.**—In September 1919,

[1] The investment in British Treasury Bills was partly dictated by the consideration that, being short-dated, there was small danger of their depreciating. The other sterling securities, on the other hand, were depreciating to a considerable extent as a result of the war.

[2] The Government of India decided to discontinue the issue of Re 1. and Rs. 2½ notes definitely from 1 January 1926. Their place was taken partly by silver rupees and partly by Rs. 10 notes. See, however, the next chapter.

[3] As has already been mentioned, these facilities were restored in 1920-1 and have since been extended by the multiplication of the branches of the Imperial Bank which provide for the encashment of notes as a matter of public convenience.

[4] See Shirras, op. cit., p. 264.

by the temporary amendment of the Paper Currency Act, the maximum limit to which the Currency Reserve could be invested was raised to Rs. 120 crores, out of which Rs. 100 crores had to be British Treasury Bills.

In March 1920, a temporary Act for six months was passed which permitted the retention of the invested portion of the reserve at Rs. 120 crores. But it abolished the restrictions as to the locale of the investments and their sterling or rupee character. This was necessitated by the then existing demand for remittances to London and the impossibility of meeting it from the Secretary of State's cash balances. The continued demand was therefore to be met by the disposal of the sterling securities held in the Paper Currency Reserve in London. This, however, involved, under the existing law, the withdrawal and cancellation of currency notes in India to the extent of the rupee value at which the sterling securities were held in the reserve, i.e. at the rate of Rs. 15 to £1.

In order to place the paper currency system on a satisfactory basis in the light of the criticism to which it was subjected by the Chamberlain Commission and the Smith Committee, and the experiences gained during the war, it was felt necessary to pass new legislation to replace the temporary Act of March 1920. Consequently, the Indian Paper Currency Amendment Act[1] became law on 1 October 1920. The provisions of this Act fall under two classes, permanent and transitory.

(i) *Permanent provisions*:[2]

(*a*) The metallic reserve was to be at least 50 per cent of the total reserve. The reasons for accepting a higher percentage than that suggested by the Smith Committee, which was only 40 per cent, were the necessity of encashing the notes without question in a country like India, and the necessity of holding sufficient coin in the reserve to finance the movements of the crops during the busy season, when notes are generally presented for encashment on a very large scale.

(*b*) With the exception of Rs. 20 crores worth of securities held in India the remainder was to be held in England in short-term securities not exceeding a period of 12 months, as suggested by the Smith Committee.

(*c*) The Controller of Currency was authorized to issue notes up to an amount of Rs. 5 crores against inland discounted bills of exchange maturing within 90 days of their issue. This extra issue was to take the form of a loan to the Imperial Bank which was to pay 8 per cent interest to the Government and deposit accepted bills of exchange with the latter. (The limit of Rs. 5 crores was raised to Rs. 12 crores by the Indian Paper Currency Amendment Act of 1923.)[3] The provision

[1] This is usually referred to as the Paper Currency Act of 1923, which was a Consolidating Act.

[2] These provisions are practically identical with the recommendations of the Smith Committee.

[3] Of the Rs. 12 crores the first Rs. 4 crores could be issued when the Bank rate was 6 per cent, the next Rs. 4 crores when it was 7 per cent, and the last Rs. 4 crores when it was 8 per cent. The procedure was revised in September 1924, when the following regulations were issued:

(i) No loan shall be made unless the Bank rate rises to 6 per cent.

(ii) The entire amount outstanding at any time shall bear interest at the Bank rate subject to a minimum of 6 per cent for the first Rs. 4 crores and of 7 per cent for the subsequent Rs. 8 crores.

regarding the fifty per cent statutory metallic reserve was irrespective of this extra issue, which was not to be considered for the purpose of fixing the metallic reserve.

(*d*) The Secretary of State was not to hold more than £5 million in gold bullion in London.

(ii) *Transitory provisions*:

Owing to the difficulty caused by the necessity of revaluing the gold and the sterling securities of the reserve on the basis of Rs. 10 to the sovereign instead of Rs. 15, certain transitory provisions became necessary pending the final attainment of the permanent provisions. With revaluation on the 10-rupee basis the metallic portion of the reserve would have been less than fifty per cent. It was therefore provided that the invested portion might, for the time being, be fixed at Rs. 85 crores.[1] Another difficulty was about filling up the gap caused by the revaluation of the gold and sterling securities at two-thirds of their former value. This was solved by authorizing the Government of India to create rupee securities of their own hand (*ad hoc* securities, as they were called) and issue them to the Paper Currency Reserve. As these created securities would exceed the limit on rupee securities laid down by the Act, it was provided that the excess should be reduced by gradually replacing them by sterling securities. But as there were no funds immediately available to purchase a large quantity of sterling securities, it was provided that the interest derived from the securities in the Paper Currency Reserve as by law, and profits on the fresh coinage of rupees, and interest on the Gold Standard Reserve when that exceeded £40 millions (which it did on 30 September 1921), and lastly, interest on commercial bills of exchange deposited with the Controller of Currency as security for the temporary issue, should be paid into the Paper Currency Reserve to reduce such of the created rupee securities as were above the permissible figure of Rs. 12 crores. The permanent provisions of the Act would thus be eventually carried into effect. On account, however, of the unsatisfactory financial position, Finance Acts of subsequent years allowed these sources of income to be diverted to revenue, except in 1921-2, when the excess in the Gold Standard Reserve was used for the extinction of the *ad hoc* securities.

On 1 April 1927, the gold and the sterling securities held in the Paper Currency Reserve, which since 1920 had been valued at Rs. 10 to the sovereign, were re-valued at the rate of Rs. 13-1-3 to the sovereign in accordance with the provisions of the Indian Currency Act, 1927, which came into force on that date. The result of this was an increase of Rs. 930 lakhs in the holding of gold and sterling securities, which was set off by cancelling the same amount of Indian Treasury Bills, the holding of which was reduced from Rs. 49,77 lakhs to Rs. 40,47 lakhs.[2]

[1] As a remedy for monetary stringency, this limit was raised to Rs. 100 crores by the Amending Act of February 1925, which also laid down that the total amount of created securities of the Government of India was not to exceed Rs. 50 crores.

[2] For the recommendations of the Hilton-Young Commission regarding the paper currency, and the effects on it of World War II, see the next chapter. The transfer of the note issue function to the Reserve Bank of India and the new arrangements regarding the reserve held against notes with effect from 1 April 1935, under the Reserve Bank of India Act (1934), are dealt with in ch. xi.

§34. **The composition and location of the Paper Currency Reserve between 31 March 1925 and 1935.**[1]—The table below reveals certain striking changes in the Paper Currency Reserve between the years 1925 and 1935. Firstly there was a very appreciable decline in the gross circulation of notes in the years 1929-30 and 1930-1 owing to the contraction of currency following the general fall in the prices of commodities which commenced in the latter part of the year 1929-30. Another factor was the tendency towards exchange weakness due partly to the fall in the prices of the great staples of export trade and partly to the tendency towards the transfer of capital abroad in view of the uncertainty of the political situation in India and the speculation regarding reversion to the old statutory ratio of 1*s.* 4*d.* This increased the difficulties of making remittances to the Secretary of State to meet the Home Charges, and goes far to explain the total disappearance, by 1931, of sterling securities in the Paper Currency Reserve, since these securities had to be transferred to the Secretary of State against corresponding contraction of notes in India. The big drop in the holdings of rupee securities in 1930-1 is explained by further contraction of currency in 1930-1 against these securities. The decrease in the amount of gold in the reserve in the same year was caused by the payment of Rs. 8$\frac{1}{3}$ crores of gold into the Indian branch of the Gold Standard Reserve against withdrawal of sterling securities of the value of £6·2 million forming part of that reserve in England, in aid of the Home Treasury balances and to meet sales of sterling at the statutory rate of 1*s.* 5$\frac{49}{64}$*d.* between November 1930 and February 1931 in response to the public demand influenced by the exchange speculation and the political situation in the country. Another remarkable change in the composition of the Paper Currency Reserve was the increase in the holdings of silver coin in the reserve owing to reasons explained below.[2] This increase would have been greater but for the removal of some quantity of silver for sale as recommended by the Hilton-Young Commission.

In crores of rupees

On 31 March	Gross circulation	Silver coin in India	Gold coin and bullion in India	Silver bullion under coinage	Securities		Internal Bills of Exchange	Percentage of securities to total reserve
					Rupee in India	Sterling in England		
1925	184·1	70·2	22·3	6·7	57·1	20·1	8·0	40·8
1926	193·3	77·2	22·3	7·6	57·1	29·0	..	44·6
1927	184·1	95·9	22·3	8·5	49·7	5·5	2·0	31·1
1928	184·8	98·7	29·7	7·6	37·9	3·7	7·0	26·4
1929	188·0	94·9	32·2	4·9	43·2	10·6	2·0	28·7
1930	177·2	108·1	32·2	2·8	33·8	0·1	..	19·1
1931	160·8	117·8	25·8	6·9	10·2	..	..	6·3
1932	178·1	102·0	5·2	9·2	57·9	..	3·8	32·4
1933	176·9	96·3	26·0	15·5	39·1	..	..	22·1
1934	177·2	86·5	41·5	11·5	29·5	8·2	..	21·2
1935	186·1	77·2	41·6	13·1	35·9	18·3	..	29·1

[1] See *Reports of the Controller of Currency*, from 1924-5 to 1934-5. The figures of the composition and location of the Currency Reserve subsequent to 1 April 1935 are given in ch. xi.

[2] See §35.

The total amount of silver sold by the Government of India from the commencement of their operations in 1927 up to 31 March 1935 amounted to 228,182,255 fine ounces. The sale proceeds were invested in sterling securities which were transferred to the Gold Standard Reserve against an opposite transfer of gold from that Reserve to the Paper Currency Reserve, an equivalent amount of rupee securities in the Paper Currency Reserve being simultaneously cancelled. The surplus balance obtained by sterling purchases in excess of the current requirements of the Secretary of State was utilized in the same way. These transactions involved an increase in the gold holdings of the Paper Currency Reserve,[1] and a corresponding reduction in the balance of rupee securities. The sale of silver also involved a reduction in the holdings of silver coin and bullion in the Paper Currency Reserve. In 1933-4 and in the following years the surplus Home Treasury balances and sale proceeds of silver were utilized in purchasing sterling securities and thus adding to the sterling assets of the Paper Currency Reserve—a welcome strengthening of the position on the eve of the transfer of Government currency activities to the Reserve Bank.[2]

Following the sale and export of gold on private account from India which commenced towards the end of September 1931, there was an appreciable increase in the amount of gross circulation of notes, which stood at Rs. 186·1 crores on 31 March 1935 and at Rs. 214·70 crores on 31 December 1937. This expansion of currency was attributed partly to the upward trend of prices before the recession of 1937 set in, and to the public demand for currency to serve as a substitute for the gold in hoards, of which about Rs. 308 crores was exported up to the end of December 1937 mainly under the stimulus of the high rupee prices of gold following the fixing of the rupee to sterling at 1*s*. 6*d*. after Britain went off the Gold Standard on 20 September 1931.[3]

§35. **Note circulation and currency absorption.**—In this section it is proposed to discuss two main questions :

(i) *Gross and active circulation of notes.*—When we speak of the circulation of the paper currency, we must be clear as to whether we are referring to gross or active circulation.

(*a*) By gross circulation is meant the value of all notes that have been issued and have not been paid off. (*b*) Active circulation since 1 April 1935, when the note issue function was taken over by the Reserve Bank of India, has meant the amount of notes issued less those held in its Banking Department.

The following table illustrates the growth of average gross and active circulation of paper currency between 1904-5 and 1939-40.

[1] The gold holdings of the Government of India on 31 March 1935—on the eve of their transfer to the Reserve Bank—amounted to Rs. 44·42 crores, of which Rs. 41·55 crores was in the Paper Currency Reserve and Rs. 2·87 crores in the Gold Standard Reserve valued at the statutory parity (i.e. Re. 1 = 8·47 grains of gold). Their actual market value on that date was approximately Rs. 76 crores.

[2] See ch. xi. *Reports of the Controller of Currency* (1933-4), par. 39 and (1934-5), par. 31.

[3] See next chapter for further explanation and ch. xi for subsequent figures of note circulation.

TABLE I

In crores of rupees

Year		Gross	Active	Year		Gross	Active
1904-5	..	39·2	28·1	1929-30	..	183·1	163·0
1909-10	..	49·6	37·2	1931-2	..	163·6	152·6
1913-14	..	65·5	46·6	1933-4	..	178·1	157·4
1914-15	..	64·0	45·4	1935-6	..	192·2	163·0
1917-18	..	101·7	71·8	1936-7	..	202·0	176·0
1919-20	..	171·6	151·1	1937-8	..	211·8	186·1
1923-4	..	179·0	156·9	1938-9	..	210·6	182·3
1927-8	..	180·1	162·6	1939-40	..	227·7	208·9

The increase in active circulation in more recent years reflected the increasing use of notes in the country as well as business recovery. The increase in 1939-40 in consequence of the conditions created by the war is explained in the next chapter.

(ii) *Absorption of various forms of currency.*—The following table[1] shows the average annual absorption of currency notes and rupee coin:

TABLE II

In lakhs of rupees

	Rupees	Notes	Total
Average for five years 1909-10 to 1913-14 ..	8,77	3,01	11,78
Average for five years 1914-15 to 1918-19 ..	22,08	16,72	38,40
1919-20 ..	20,09	20,20	40,29
1920-1 ..	— 25,68	— 5,90	— 31,58
1923-4 ..	7,62	7,96	15,58
1925-6 ..	— 8,11	1,16	— 6,95
1926-7 ..	— 19,76	— 3,40	— 23,16
1927-8 ..	— 3,71	10,22	6,51
1928-9 ..	— 3,03	3,66	63
1929-30 ..	— 21,71	— 18,80	— 40,51
1930-1 ..	— 21,58	— 11,37	— 32,95
1931-2 ..	3,93	17,24	21,17
1932-3 ..	— 7,56	— 14,83	— 22,39
1933-4 ..	— 30	13,54	13,24
1934-5 ..	— 3,21	— 32	— 3,53
1935-6 ..	— 9,46	1,82	— 7,64
1936-7 ..	— 2,49	25,53	23,04
1937-8 ..	— 6,52	— 8,23	— 14,75
1938-9 ..	— 12,60	2,98	— 9,62
1939-40 ..	10,08	49,45	59,53
Average for 21 years 1919-20 to 1939-40 ..	— 5,74	5,00	— 74

[1] Sovereigns and half-sovereigns have been omitted from the table. From 1 April 1927 they ceased to be legal tender and from 1914 they did not function as currency. Since the Reserve Bank assumed the management of currency on 1 April 1935, the figures for absorption or return of currency are arrived at in the following manner. The absorption or return of currency is the variation in the totals of notes in circulation as shown in the returns of the Issue Department of the Bank. Notes in circulation thus now include amounts held in Government treasuries as well as notes in circulation among the public. The absorption or return of rupee coin means the decline or rise respectively in the amount of the rupee coin held in the Issue Department of the Bank. For the method of calculating the absorption of currency before the inauguration of the Reserve Bank see the old annual *Reports of the Controller of Currency.—Report on Currency and Finance*, 1935-6, par. 47 and 1939-40, par. 50 (published by the Reserve Bank of India).

This table shows striking changes in the relative popularity of coin and paper and in the absorption of currency before, during and after the war of 1914-18. The war-time expansion of currency on a large scale in the form of both rupees and notes due to factors already examined is brought out by the figures. The large contraction of currency in 1920-1 represents the effects of the adverse balance of trade and the sale of Reverse Councils. The twenty years that followed the war of 1914-18 were with few exceptions a period of return of silver rupees from hoards on the one hand and the partial replacement of coin by notes, on the other. One of the causes for the return of rupees from hoards was the substitution of gold bullion for rupees in hoards as a store of value due to the considerable drop in its price in India below the level prevalent before the war of 1914-18, prior to the rapid rise in the rupee price of gold in consequence of India going off the gold standard with effect from 21 September 1931. (See next chapter.) The increasing popularity of notes, the spread of banking facilities and the freer acceptance of bearer cheques have decreased the demand for rupees. The practice of privately railing rupees has been declining rapidly. The drop in the prices of certain staples of trade like cotton and jute, and the general trade depression during the period 1929-33, were responsible for the lessened consumption of coined rupees and notes. The currency policy of the Government in these years was criticized on the ground that there was excessive contraction of currency (e.g. in 1929-30 and 1930-1) which created a shortage of money in the country, producing a fall in prices and inconveniencing trade. Sir George Schuster, however, held that the reduction in the volume of currency was a sequel to the fall in world prices and had not been carried to an excessive extent.[1] With the upward trend of prices and partial economic recovery the absorption of note currency increased, although it was partially set off by a return of silver coin. We have already referred to the public demand for note currency to serve as a substitute for the gold in hoards sold and exported. The total amount of currency absorbed in 1936-7 amounted to Rs. 23·04 crores. The economic recession was responsible for a net return of currency to the extent of Rs. 14·75 crores in 1937-8 and Rs. 9·62 crores in 1938-9. The total amount of currency absorbed in 1939-40 amounted to Rs. 59·53 crores. The addition was made up of an absorption of Rs. 10·08 crores of rupee coin and Rs. 49·45 crores of notes. This was the largest absorption of currency recorded in any year excepting the year 1918-19, when it amounted to Rs. 94·20 crores, and was traceable to the increased trade activity in India and the rise in prices that followed the outbreak of war in September 1939. Not since 1919-20 was there an absorption of rupee coin larger than in 1939-40. This was, to some extent, due to brisker trade and bumper crops, but also, in part, to a tendency to hoard coin and preference for metal in the conditions created by the war. This tendency gathered momentum in subsequent months owing to the growing tension of the war situation and it had to be checked by the issue of Government of India one-rupee notes in July 1940. (See the next chapter.) The total notes issued as on 14 February 1947 amounted to just over Rs. 1,257 crores.

[1] *Central Budget for* 1931-2, pp. 28-9; and see also ch. ix, §17.

The following table gives figures for absorption of currency from 1940-1 to 1946-7:

TABLE III[1]

In crores of rupees

	Rupees including one-rupee notes since July 1940	Notes	Total
1940-1	33·23	19·11	52·34
1941-2	7·18	152·40	159·58
1942-3[2]	44·93	261·85	306·78
1943-4[2]	25·60	238·91	264·51
1944-5[2]	10·05	202·39	212·44
1945-6[2]	18·35	133·89	152·24
1946-7[2]	1·94	23·26	25·20

The particular method adopted by Government for financing the heavy purchase of materials from India for the prosecution of the war resulted in a phenomenal increase of sterling securities in the currency reserves abroad and heavy additions to the note circulation at home,[3] as may be seen from the figures of absorption of notes from 1940-1 to 1944-5. With the termination of the war in 1945, the pace of currency addition naturally slowed down very substantially.

The study of the absorption of currency month by month reveals the fact that currency is absorbed generally in the busy season from November to June and returns to currency offices and treasuries in the slack season from July to October.[4]

[1] See statement XLII in the *Report on Currency and Finance*, 1946-7.
[2] India only. [3] See ch. xii, section on Sterling Balances. [4] See also ch. xi.

CHAPTER IX

CURRENCY AND EXCHANGE (PART II)

THE HILTON-YOUNG COMMISSION AT WORK

§1. **Defects of the gold exchange standard.**—The report of the Hilton-Young Commission was published on 4 August 1926. Before propounding their own scheme of a monetary standard for India, the Commission indicated the following defects of the system as it existed :[1]

(i) The system was far from simple, and not readily intelligible.[2] The currency consisted of two tokens, rupees and rupee-notes, in circulation, with the unnecessary excrescence of a third full-valued coin (the sovereign), which did not circulate at all. One form of token currency (rupees) into which there was an unlimited obligation to convert the other (rupee-notes), was highly expensive and was liable to vanish if the price of silver rose above a certain level, when it ceased to be a token coin.

(ii) There was a cumbrous duplication of the reserves, namely, the Gold Standard and Paper Currency and Banking Reserves, with an antiquated and dangerous division of responsibility for the control of currency and credit policy, which in other countries is centralized in and fixed upon a central bank. In India, the Government controlled the currency, and the credit situation, so far as it was controlled at all, was controlled by the Imperial Bank.

(iii) The system did not secure automatic expansion and contraction of currency. Such movements were too wholly dependent on the will of the currency authority, that is, of the Government. The system did not automatically enforce contraction of internal currency concurrently with the depletion of the reserves.[3]

Similarly, with regard to expansion, on occasions the obligation to buy sterling had been discharged by the Government without any corresponding expansion of currency. The purchases had in the first instance been made against Treasury

[1] See *Hilton-Young Commission Report*, par. 21.

[2] The basis of the stability of the rupee was not only not readily intelligible, but it also had other faults. Mr Denning, Controller of Currency, wrote: 'The system did not provide for the automatic stabilization of the rupee. The legal obligation to give rupees in exchange for sovereigns would have prevented the rate of exchange rising above the upper gold point, even if the Government had not been prepared to meet fully the demand for Council Bills at 1*s.* 4⅛*d.*, but there was no statutory safeguard against a fall in the rate of exchange below the lower gold point. In practice, such a fall in the rate of exchange was prevented by the sale of Reverse Councils, but Government were under no statutory obligation to take such action.' See *Hilton-Young Commission Report*, vol. II, Appendix.

[3] As Mr Denning pointed out in his Memorandum to the Commission, the provision for the automatic contraction of currency was particularly defective. 'In so far as the sterling value of the Reverse Councils sold was obtained by realizing sterling securities in the Paper Currency Reserve, the currency was contracted, but Government could arrange, by borrowing from the Gold Standard Reserve, to meet sterling payments on account of Reverse Councils without affecting the amount of currency in circulation.' See *Currency Commission Report*, vol. II, Appendix.

balances and the currency expansion had been left to be effected at the discretion of the Government.

(iv) Lastly, the system lacked elasticity. The utility of the provision for elasticity made on the recommendation of the Smith Committee was affected by the methods of financing Indian trade. These were based on a system of cash credits or the advance of money against demand promissory notes. There was therefore, a shortage of genuine inland trade bills as cover against the seasonal increase of currency. The Government had, therefore, to announce in September 1924 that, as far as might be necessary, they would use their powers to issue currency against Treasury Bills deposited in the Paper Currency Reserve in London.

Other points of criticism not prominently brought out by the Hilton-Young Commission Report but already sufficiently familiar to currency controversialists may conveniently be brought together here.

§2. **Reserves and balances.**—We have already seen how reserves and balances created for a particular purpose were indiscriminately utilized for all sorts of purposes. The utilization of the reserves and balances was never governed by a consistent policy, with the result that they were sometimes treated separately and at other times mixed up, thus causing great confusion.

The position as regards the composition of the Gold Standard Reserve was unsatisfactory. It was mainly invested in long-term securities and a very small part of it was held in a liquid form. The Chamberlain Commission recommended that a large proportion of it should be held in a liquid form[1] and in easily realizable securities and that the silver branch of the Gold Standard Reserve should be abolished. The latter suggestion was carried out by the Government, but the other recommendations could not be given effect to owing to the outbreak of war in 1914. During that war almost the whole of the reserve was held in securities in London, and British War Bonds and Treasury Bills were purchased. The recommendation that the securities should be easily realizable was carried out by investment in short-term securities.

The Smith Committee recommended that it was desirable to hold a considerable proportion of the reserve in gold. They also recommended that the securities should be short-term securities issued by a Government within the British Empire other than the Government of India.

The position of the Gold Standard Reserve, before its amalgamation with the Paper Currency Reserve and transfer to the Reserve Bank of India with effect from 1 April 1935,[2] was that it was largely held in London mainly in short-term paper of various kinds.

A part of the Paper Currency Reserve was also placed in London. The Chamberlain Commission justified the location of the Gold Standard Reserve in London on the ground that London was the clearing house and the loan market of the world. Further, India's principal customer was the United Kingdom, and London was the chief place where money was required both for the expenditure of the Secretary of State on India's behalf and for the payment of India's commercial obligations to England and the world in general. If the reserve were kept in India, it would have to be shipped to London, involving unnecessary delay and

[1] See ch. viii, §18. [2] See §24 below and ch. xi.

expenditure. Also there was no short-loan market in India, and the location of the reserve there would be wasteful because it would be unable to earn any interest. Again, the practice of holding foreign bills followed by the Central Banks in certain European countries provided an analogy to the Indian system of holding the reserve in London.

These complicated arrangements regarding the location of the reserve were possibly primarily intended for meeting situations of exchange weakness caused by an unfavourable balance of trade. In view of the fact, however, that an unfavourable balance of trade is an abnormal phenomenon in the case of India (occurring about once every ten years) it was not necessary to maintain such elaborate standing arrangements to meet what is after all a rare contingency.

The Secretary of State could have easily put himself in funds for meeting his expenditure without the reserve being kept in London for this purpose. And clearly the main object of the reserve was not the convenience of the Secretary of State in this respect.

As regards the absence of a short-loan market in India, it was not true that there was no scope for short-term investment in this country, as the experience during and after the war of 1914-18 proved. In any case, interest could not be considered to be the decisive factor in determining the location of the reserve.

Other countries, even if they have an unfavourable trade balance as the normal feature of their international trade, did not usually maintain a reserve at foreign centres. There was no such reserve, for example, kept by any foreign country in India itself on the ground that year after year it had to make payments to India in settlement of trade obligations.

With regard to the Paper Currency Reserve, it was an anomalous position that the reserve intended for securing the convertibility of the notes circulating in one country should, instead of being kept there, be located 6,000 miles away, thus impairing the confidence in the note issue. One of the reasons given for this practice was that London was the cheapest and best organized market for silver, for the purchase of which it was convenient to hold ample funds in hand. But if England, not being a producer of silver, is yet the best market for silver, there was no reason why an equally efficient market for the metal could not have been developed in India if the Government had consistently made their purchases in the country itself. Instead of making any attempts in these directions, the Government may be said to have actually impeded the development by the imposition of an import duty on silver. Again, even supposing purchases were to be made in London, there was no particular harm in transferring funds from India when they were actually wanted instead of holding them there in advance. The inconvenience and additional expense would have been well worth while as tending to allay popular suspicion and discontent. It would also seem that in circumstances of urgency, arrangements could have been made for raising the necessary funds in England, for example, with the assistance of the Bank of England, pending the transfer of money from India. Lastly, the secrecy with which the dealings in connexion with the purchases of silver were shrouded naturally led to much adverse criticism.

§3. Management of remittances.—As we have already seen, the sale of Council Drafts by the Secretary of State was the machinery employed for drawing funds

from India to London. The complaint in this connexion was that unnecessarily large amounts were transferred from India to London by this method, especially after 1904. This was defended on the ground that it enabled the Secretary of State to strengthen his financial position. No explanation was, however, offered why such strengthening was needed. Similarly, it was said that it was desirable that the Secretary of State should avail himself of exceptionally profitable rates for the Council Bills whenever they could be obtained. Here again the assumption is tacitly made that the question whether the funds were required was of subordinate importance. It was often claimed that by drawing more money than was immediately required for his expenditure the Secretary of State made possible an avoidance or reduction of debt. But these excessive drawings encouraged the policy of surplus budgets in India. Instead of the avoidance or reduction of debts, remission of taxation in India would have been a more worthy object to pursue.[1] Besides, it was noticed that even when the Secretary of State's cash balances were ample, large floating loans were raised in London.

The superfluous money which accumulated in the hands of the Secretary of State in this manner was loaned out in London at very low rates of interest to 'approved' borrowers, of whom a list was maintained by the Secretary of State. Complaints were common that a good deal of favouritism was shown in the administration of these loans, and colour was lent to these complaints by the fact that the members of the Finance Committee of the Secretary of State's Council were often themselves directors and business men who were interested in selecting the recipients for these loans.

Another practice that was objected to was that the Council Bills were often sold at rates below the specie import point even when there was no urgent necessity for funds in London.

One of the principal justifications urged for the sale of Council Bills beyond the requirements of the Secretary of State was that it was a great help to the foreign trade of India. But the trade was fully capable of looking after itself and would have had no difficulty in finding alternative means of financing itself, as in fact it had done with sufficient ease whenever the sales of Council Bills happened to be curtailed. There was thus no overwhelming reason why the Government should have gone out of their way to assist trade. All that they need have done was to make gold freely available for export whenever required.

The Council Bill system had all the appearance of an elaborate device for diverting the flow of gold from India and saving London the inconvenience and cost of finding it for India, 'while acting as a receptacle for as much of India's gold as possible—not to hold but to use'.[2]

In his memorandum to the Babington Smith Committee, Sir Stanley Reed pleaded forcefully for an abolition of the control over the Indian exchanges exercised by the Secretary of State. He urged that the Government of India, and to no less a degree the Secretary of State, were suspect in the eyes of a large section of the Indian people. The Secretary of State, he pointed out, operated 6,000 miles

[1] See ch. xii.

[2] See *Indian Currency and Finance* ('Times of India' Press, 1913), p. 57.

from the great Indian financial centres. 'He was surrounded by, and naturally amenable to, interests not Indian in their ideas and aims. He acted in secret, and it was frequently impossible to obtain any information in India of the groundwork of measures which, however wise and expedient in themselves, were not understood and were liable to perversion in India. The political disadvantages of such complete powers being exercised in secret so far from the people vitally affected by them could not be easily exaggerated.'

The real objection to the Indian system was not that it was managed—for in most civilized countries management in some form or other is essential—but that it was ill managed. In the words of Professor Nicholson, 'it is a bad thing for a country when the masses of the people begin to feel that something is wrong with the currency', and, whatever the inherent excellences of the gold exchange standard, it certainly had made the people of India think that something was very wrong with their currency system.

§4. **Inflation of currency and rise of prices.**—The Hilton-Young Commission, as we saw, pointed out that the Indian system was unautomatic and was especially defective on the side of contractibility of superfluous currency. One of the inevitable results of this was an inflation of currency and an excessive upward movement of Indian prices.[1] As Professor Nicholson pointed out in his criticism of the Report of the Chamberlain Commission, since the convertibility of the rupee was partial and often suspended, it was unavoidable that in course of time, if new additions continued to be made, the cumulative effect must come into operation, causing a general rise in prices.

With the best intentions in the world, the Government were liable to grave errors of judgement in ascertaining the currency requirements of the country.[2] The demand for rupees often appeared to be quite sound and necessary without its really being so, and misjudgements were particularly easy as the rupees once issued to the public went up-country and did not come back quickly.

§5. **A haphazard and expensive system.**—The gold exchange standard in India resulted from a series of administrative notifications not consistently informed by any deliberately adopted ideal. Many of the practices that had come into vogue as integral parts of the system had no legal validity. As the late Sir Dadiba Dalal remarked in his Minute of Dissent (pars. 59-60), the system as a whole was never clearly and explicitly defined, and this had a generally unsettling effect.

The gold exchange standard was often commended for its cheapness relatively to a gold standard proper. But if we allow their proper value to all its disadvant-

[1] See ch. x.

[2] 'Here in India, Government has been attempting too much; it has taken upon itself the whole task of providing the necessary supply of currency, and adjusting it to varying needs of different occasions—a task not completely entrusted even to a banking institution in any other great country of the world—a task beyond its ability and one that exposes it to undesirable pressure . . . In fact since the closing of the mints the Indian currency system has been managed at the whim of the latest official sent out from England. One man could come along and stuff the currency, the next would starve it. There has been no plan at all . . . but always some fresh experiment advised—a gold mint, prohibitive duties on silver bullion—anything or everything.' Moreton Frewen's evidence before the Chamberlain Commission. See also H. L. Chablani, *Studies in Indian Currency and Exchange*, pp. 93-4.

ages as detailed above, it would be excusable if we concluded that the cheapness of the system was very dearly bought indeed!

The system had also failed to destroy the hoarding habit and teach the people to appreciate the benefits of economical forms of currency.

§6. **Internal versus external stability.**—In order to be quite fair to the gold exchange standard, we must count its successes as well, as its failures. One of the achievements with which it has been credited has been that it gave the country a long period of exchange stability. Of course it broke down utterly during the war of 1914-18 but so did almost every other currency in the world. On the whole, the gold exchange standard succeeded in keeping the foreign exchanges more stable than under the silver standard. We must, however, hasten to add that not all its critics were ready to admit even so much. They pointed out that even if the war period was excluded from consideration, the system could not be said to have stood the test proposed for it. The only time that it was put to the proof before the war was during the crisis of 1907-8, and then it was kept standing only with the help of outside supports. The Government had to give an undertaking to borrow, if necessary, to maintain the standard, and were compelled to increase taxation in order to lay down gold. It was therefore only a fair-weather system, which threatened to collapse at the least sign of a storm. However, even if we admit that prolonged stability of exchange was one of its positive achievements, we must put against this the internal instability of prices with a general tendency towards a rise which it occasioned. Most economists agree that stability of internal prices is far more important than stability of the foreign exchange.

These imperfections of the system had created much distrust, which had been further intensified by too much being left to executive action and by the absence of statutory regulation of the duties of the Government as the currency authority. A substantial measure of external stability had been attained in the past. But what was lacking was the certainty and simplicity so necessary to ensure confidence in the currency system and to wean the uninstructed public from hoarding and the disinclination to investment.

§7. **The gold bullion standard.**—The Commission, after examining several proposals for reform, came to the conclusion that the establishment of a true gold standard was necessary in the circumstances of India. They argued, however, that it was possible to have a true gold standard without putting gold into circulation. They proposed 'that the ordinary medium of circulation in India should remain, as at present, the currency note and the silver rupee, and that the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold for all purposes, but that gold should not circulate as money. It *must* not circulate at first and *need* not circulate ever'. (Par. 54.)

The chief reason, according to the Commission, against putting gold into circulation was that the larger the amount of such gold in circulation, the smaller the gold reserves and the greater the inelasticity of the credit structure based on them. They endorsed the view of the Chamberlain Commission that gold in circulation is of doubtful value for the support of exchange. The Commission also urged that the gold bullion standard promised to set up almost immediately a full gold standard and dispensed with any period of transition contemplated in the

other schemes. While providing for the gradual strengthening of the gold reserves at a rate which would not have any unsettling effects on world conditions, the scheme was capable of adjusting itself to any future decision in favour of a gold currency, which it was impossible to introduce all at once, but for which the door would be left open. The Commission's own view was that it would be unwise to contemplate the introduction of a gold currency under any conditions, and they expressed the hope that India would, in course of time, come to look upon it as an obsolete and outworn ideal. The war had taught the European nations to dispense with the expensive luxury of a gold currency. Indeed, according to some high authorities, gold in circulation was coming to be regarded as a sign of a backward civilization. Under the Commission's scheme the obligation to be imposed by statute on the currency authority was: to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold was required, so as to ensure the stability of the gold value of the rupee and the stability of exchange within the gold points corresponding to the selected parity. Gold was thus to be made the real standard of value. The rupee was to be linked to gold and not to sterling or any other currency or group of currencies. While the system was an absolute gold standard and not an exchange standard as hitherto, because rupees and notes were to be convertible into gold bars for *any* purpose, the compensatory mechanism of the exchanges was preserved, as gold bars were not currency. The currency would be expanded when notes or rupees were issued by the currency authority in exchange for gold bars, and contracted when it gave gold bars for notes and rupees.

The conversion of rupees into gold bars and not coin, the demonetization of the sovereign (proposed in order that the existing hoards of gold coins might be prevented from entering into circulation) and the system of gold savings certificates proposed by the Commission would all tend to rob the hoards of their power of disturbing internal prices and money rates.

§8. **Buying and selling rates for gold.**—Buying and selling rates for gold, fixed with reference only to the par value of the rupee and without reference to the costs of importation or to any deviation in the value of the currency from its gold parity, would make the currency authority the cheapest market for gold. This would not only destroy the gold bullion market in India, but would also saddle the currency authority with the work of selling gold for non-monetary uses, which did not properly belong to it. In order to free it from this obligation, the Commission recommended that the selling prices of gold should be fixed at such rates as would make possible the replenishment of the stock of gold without loss by importation from London.[1]

[1] The par value of the rupee as proposed by the Commission was 1*s*. 6*d*. (8·47 grains of fine gold) or Rs. 13·37 for £1. The par value of a tola of gold at this rate was Rs. 21-3-10. The Commission proposed as many as three different selling rates for gold, based on London as the gold centre for India: (i) When the T.T. rate on London was at or above the upper gold point (1*s*. $6\frac{13}{64}$*d*.), the selling rate for delivery in Bombay was to be the same as the buying rate, viz. Rs. 21-3-10 per tola of fine gold.

When the T.T. rate on London was below the upper gold point, the selling rate (ii) for

The Commission proposed the removal of the legal tender quality of the sovereign so long as the amount of gold in the reserves was not big enough for the introduction of a gold currency, and so long as no definite decision in favour of a gold currency was taken. Otherwise, the gold from the reserves might pass into circulation, preventing any contraction in the currency and counteracting the compensatory effect of the exchanges.

§9. **Convertibility of notes.**—The Commission recommended that the existing anomaly in the Indian currency system due to the obligation of the Government to convert one form of note, namely the note printed on paper, into another form, namely the rupee, which is merely a note printed on silver, must be removed, to rid the system of the threat involved in a rise in the price of silver. Of course, the promise to convert the existing notes into rupees must be kept. But no obligation for conversion into silver rupees should attach to the new notes. It was, however, essential that facilities for the free exchange of notes for rupees should be provided, so long as the people desired to obtain metallic rupees, in order to inspire public confidence and ensure the popularity of the note issue.

The Commission proposed the re-issue of the one-rupee note with full legal tender power and, like the other notes of the new status, not legally convertible into silver rupees. This would help in popularizing the use of notes and offering a way out, in case the price of silver should ever again rise above the rupee-melting point.

In view of the withdrawal of the existing legal right of convertibility of notes into rupees, it was necessary to impose a statutory obligation on the currency authority to convert all notes, except the one-rupee note, on demand into legal tender money, that is, into notes of smaller denominations or silver rupees *at the option of the currency authority*, though all reasonable demands of the public for metallic currency should be met in practice.

§10. **Unification and composition of the reserves.**—The Commission recommended that the paper currency and gold standard reserves should be combined into one currency reserve so as to ensure the efficiency of its working and make it simpler and more intelligible to the public.

As regards the new reserve, the Commission recommended that: (i) The composition and promotion of the reserve should be laid down by statute so as to ensure automatic expansion and contraction of currency and the compensatory effect of the exchange. (ii) The proportional reserve system should be adopted, and gold and gold securities should form not less than 40 per cent of the reserve. The currency authority should strive to work up to a reserve ratio of 50 to 60 per cent. The gold holding should be raised to 20 per cent of the reserve as soon as possible, and 25 per cent within ten years. During this period no favourable opportunity of fortifying the gold holding should be allowed to escape unutilized. Of the gold holding at least one-half should be held in India. (iii) The silver holding in the reserve should be very substantially reduced during a transitional period of ten years. (iv) The balance of the reserve should be held in self-liquidating

delivery in London was to be Rs. 21-7-9 (allowing for cost of transport to London); (iii) while for delivery in Bombay it was to be Rs. 21-11-9 (allowing for twice the cost of transport). See *Hilton-Young Commission Report*, p. 95.

trade bills and Government of India securities. The 'created securities' should be replaced by marketable securities within ten years. (v) Rs. 50 crores might be regarded as the approximate liability in respect of the contractibility of the rupee circulation. An amount equal to one-fifth of the face value of any increase or decrease in the number of silver rupees in issue should be added to or subtracted from this liability, and the balance of profit or loss should accrue to or be borne by the Government revenues.

The Commission urged that the fortification of the gold reserves in the manner described above would involve the minimum risk and expense and was necessary (i) to enable the currency authority to discharge its obligation to sell gold in exchange for currency and in view of the new status of the notes which were convertible into gold; (ii) to enable the Government to encash the gold certificates in case they proved to be popular; and (iii) to facilitate the introduction of a gold currency if it was decided to have it.

In the opinion of the Commission, silver reserves were out of place in a gold standard system, but the peculiar position of the rupee, due to the fact that it forms a large proportion of the total circulation, and the considerable seasonal ebb and flow in this form of currency, made it necessary to hold a part of the reserve in silver. The one-rupee note would reduce the quantity of rupees required, and therefore the silver holding in the reserve should be lessened in the period of transition, from Rs. 85 crores (on 30 April 1926) to Rs. 25 crores.

The Commission recommended that the rupee securities of the Government of India held in the reserves should be limited to an amount equal to so much of the circulation as was unlikely to be withdrawn, plus such further amount as could be easily realized without disturbing the Government's credit, because such securities are less desirable as assets than trade bills, which, unlike the former, possess the quality of automatically expanding and contracting currency in accordance with the needs of the country, independently of the will and judgement of the currency authority. Moreover, a larger holding of Government securities would make their realization, in case of need, difficult. The new arrangements for the issue of paper currency and the position of the Currency Reserve since the establishment of the Reserve Bank of India in 1935 are reviewed in chapter xi.

Gold Bullion versus Gold Currency Standard

§11. Criticism of the gold bullion standard.—The Commission claimed for the gold bullion standard which they advocated that it made gold the sole standard of value and ensured the absolute convertibility of the internal currency into gold for all purposes, though it so arranged matters that, while gold was to be always available in exchange for currency in India, gold would remain in the central reserves for use in supporting the exchange value of the currency, but would not go into circulation.[1] The latter object was to be fulfilled by the demonetization of the sovereign and the sale by the currency authority of gold in the form of bars. Its purchase from the same authority by the public for non-currency purposes was to be guarded against by offering gold in quantities of not less than 400 ounces (or 1,065 tolas) at a time and at a rate inclusive of the cost of importing gold from London to Bombay.

[1] Sir Basil Blackett's speech at Delhi, 23 November 1926.

The convertibility of legal tender currency into gold bars might be good enough for banks and bankers, but for the masses it was quite inadequate and unintelligible. Also the minimum limit of 400 ounces was excessive and was calculated to impede the convertibility into gold so much as to make it unreal. The demonetization of the sovereign and half-sovereign was widely criticized as a definitely retrograde step, since even under the exchange standard before the war of 1914-18, a considerable number of sovereigns, estimated at £6,000,000, were in the hands of the public. Even in England, under the new currency arrangements of 1925, the sovereign was not demonetized.

§12. **Case for a gold currency standard in India.**—The Commission's scheme of the gold bullion standard was obviously influenced by the analogy of the English system. The restoration of the gold standard in the form of a bullion standard in England in 1925, it was said, marked a considerable advance in the world's currency evolution towards the ideal system of an international exchange standard as recommended by the Geneva Conference in 1922, under which the internal currency would consist of inconvertible paper, and gold would be available only for liquidating foreign debts. In India conditions in 1926 pointed to a gold standard with its usual concomitant of a gold currency. Under those conditions in India a gold currency could not be regarded as an unnecessary luxury or a mere matter of traditional etiquette associated with the gold standard. This is why almost all Indian witnesses, and some European witnesses of unquestioned competence, like Dr Cannan and Dr Gregory,[1] strongly urged on the Hilton-Young Commission the need for the adoption of a gold currency standard. Sir Basil Blackett himself expressed the view that before India could think of any ideal system she would probably have to pass first through the stage of having gold coin available, into which all other forms of currency would be convertible at will. The simplicity and intelligibility, which the Commission admitted as being indispensable requisites of any currency system that could be regarded as satisfactory for India, could not be said to be the distinguishing features of the gold bullion standard as recommended by them.

§13. **Other objections to the Commission's proposals.**—The buying and selling rates of gold proposed by the Commission were also subjected to unfavourable comment. The regulation of the rates in such a manner that the currency authority would buy gold when it was cheapest and sell it when it was dearest in the market would have the effect of making the buying and selling transactions rare in India. This applied especially to the sale of gold by the currency authority. The public would buy only when the purchase was necessary for export purposes. Further, the offer to sell gold at a more favourable rate in London than in Bombay, proposed by the Commission when exchange was below the upper gold point, would encourage, or perhaps was intended to encourage, the delivery of gold in London. This was objected to as perpetuating one of the evils of the gold exchange standard.[2] In this connexion we may refer to the Commission's recommendation that 'of the [Reserve] bank's holding of gold coin or bullion, at least one-half shall be held in the bank's custody in India, while the remaining half may be held

[1] See *Hilton-Young Commission Report*, Appendixes 80 and 81.
[2] See P. B. Junnarkar, *An Examination of the Currency Commission's Report*, p. 55.

outside India in the custody of its branches or agencies or deposited in other banks earmarked for the bank's account. Gold in any mint or transit belonging to the bank shall be counted as part of its reserves' (par. 145). The large holding of gold securities recommended by the Commission meant that our reserve to that extent would be invested abroad. In view of the suspicion and distrust which the practice of holding reserves in London had engendered, special care was necessary not to propose any arrangements which would involve the location of Indian money in London.

While the Commission's recommendation that the exchange standard should be definitely scrapped, and that the official control over currency and exchange should disappear utterly and for ever, was well received, the gold bullion standard, which they proposed as an effective remedy for all the evils of the exchange standard, did not excite public enthusiasm. A genuine type of gold bullion standard suited to Indian conditions would have been more acceptable failing the full-fledged gold currency standard at the time the Commission's recommendations were made (1926).

Stabilization of the Rupee

§14. **The ratio of stabilization.**—The Commission recommended that the rupee should be stabilized in relation to gold at a rate corresponding to an exchange rate of 1*s.* 6*d.* for the rupee, thus giving it the value of 8·47 grains of gold. They thought that at that rate prices in India had already attained a substantial measure of adjustment with those in the world at large, and that any change in it would mean a difficult period of adjustment and widespread economic disturbance.

The Commission argued that when exchange and prices had been steady over a considerable period, there was justification for assuming that wages were in adjustment unless there were clear indications to the contrary. The statistics of foreign trade appeared to strengthen the assumption. As regards contracts, the Commission argued that the bulk of the contracts were short-term and were therefore not affected by the higher ratio.

As regards the contention that the 1*s.* 4*d.* rate was the 'natural' rate for the rupee, the Commission argued that the only rate which could be properly regarded as natural was the figure at which prices were in adjustment with the existing volume of currency and in equilibrium with external prices. And from this point of view 1*s.* 6*d.* appeared to them to be clearly the 'natural' rate in the existing circumstances. If, on the other hand, by natural rate was meant that rate which would establish itself in the absence of statutory enactment or executive action to anchor the rupee at a particular point, on this supposition there would be such extensive fluctuations in the rate of exchange in a country like India, with its wide seasonal fluctuations of trade, that it would be impossible to distinguish any particular rate as 'natural'.

Even if the view that prices and wages had been substantially adjusted to the 1*s.* 6*d.* rate were challenged, it could not be seriously contended that they were in any way adjusted to the rate of 1*s.* 4*d.* because that rate had never been effective sufficiently long during the preceding eight years or so. In so far as adjustment had taken place at all, it must have been to the higher rate of 1*s.* 6*d.* The reversion

to 1*s*. 4*d*. in these circumstances was bound to produce a general rise of prices to the extent of 12½ per cent, a change which would press severely on consumers in general and especially on the poorer paid members of the literate classes. It would also result in an arbitrary reduction of the real wages of labour for which there was no justification in equity or in expediency. The finances of the Government, central as well as provincial, would be seriously upset by a reversion to 1*s*. 4*d*., which would postpone indefinitely the long and loudly called-for abolition of provincial contributions.

§15. **Minute of dissent.**—Sir Purshotamdas Thakurdas in his Minute of Dissent pointed out how the Government had made up their mind to raise the exchange to 1*s*. 6*d*. and had confronted the Commission with a *fait accompli* so as to prejudice both their inquiry and finding. He showed how the Government threw away the opportunity in September and October 1924 of stabilizing the rupee at the pre-war rate of 1*s*. 4*d*. and used the fictitious ratio of 2*s*. gold on the statute book as a potent weapon for rigging up the exchange—a procedure which involved serious contraction of currency.

His main conclusions were as follows :

(i) No adjustment in wages had taken place and none was likely without a struggle. (ii) Until adjustment was complete, the 1*s*. 6*d*. ratio presented the foreign manufacturer with an effective, though indirect, bounty of 12½ per cent, which would place a heavy strain on Indian industries. (iii) A change in the ratio would mean an additional burden of 12½ per cent on the large bulk of the debtor class who were mainly agriculturists. The debt being an old one of long standing, it was natural to assume that it was mostly contracted on a 1*s*. 4*d*. basis. (iv) The adverse effect on public finances of a reversion to 1*s*. 4*d*. had been exaggerated. (v) The adverse effects of 1*s*. 4*d*. on a small section (about 21 per cent) of the population consisting of the poorly paid members of the literate classes must be allowed less weight than the suffering which the higher ratio would entail in the case of the remaining 79 per cent of the total population. As to labour, the existing rate of wages was sufficiently high to cover a possible rise in prices caused by the adoption of 1*s*. 4*d*. In any case there was the compensating advantage of continuity of employment due to the fact that the lower ratio would ensure greater prosperity to industry and agriculture, while the higher ratio was sure to injure both. (vi) The ratio of 1*s*. 4*d*. prevalent before the war of 1914-18 was disturbed as a result of the war in common with the ratios of other countries of the world. But other countries had invariably striven to restore their pre-war ratios. Even if it were granted that the disturbance involved in either case was equal, the decision should still be in favour of 1*s*. 4*d*.

§16. **The ratio controversy examined.**—The majority Report and the Dissenting Minute together provided a complete armoury from which combatants on either side drew their weapons in the fierce controversy which raged round the question of the ratio. However plausible the arguments may look at first sight, on a closer scrutiny it is possible to detect several flaws in the reasoning employed by the advocates as well as the opponents of the new ratio.

(i) *Criticism of the Majority's arguments.*—The Majority began by pointing out that the index numbers, on which they based their arguments regarding the

price adjustments to the 1*s.* 6*d.* ratio, were by no means an infallible guide.[1] But by the time they had finished their calculations based on these admittedly imperfect index numbers, they had somehow succeeded in attaining an absolute conviction that substantial adjustment had undoubtedly taken place, and they worked themselves up to an almost apostolic fervour in favour of 1*s.* 6*d.*, forgetful of their own warning about the unreliability of the index numbers. (Sir Purshotamdas also laid himself open to a similar criticism when, from the same statistical material as employed by the Majority, he obtained a precisely opposite conclusion and showed an equally unwarranted and unquestioning faith in the accuracy of his results.)

No statistical evidence was adduced by the Majority to show that wages were in adjustment with the ratio, except in the case of the jute industry. As regards long-term contracts, the Commission argued that the 1*s.* 6*d.* rate did not constitute a hardship, because, for example, in the case of the land revenue settlements, the real incidence of land revenue had been materially lightened owing to the great rise in prices since 1914. They argued against the concealed reduction of the wages of the millhands by manipulation of exchange, and, for the sake of consistency, they should have regarded the concealed increase in the land revenue assessment as one of the valid points against the 1*s.* 6*d.* ratio.

The Majority, while rightly admitting that the influence of the ratio on Government finances must not be regarded as a decisive factor, were nevertheless not able to resist the temptation of exploiting the argument for all it was worth and more.

The Majority objected to a reversion to 1*s.* 4*d.* on the ground that it would entail undeserved suffering for the poorer paid literate classes. Considering that these classes had suffered more than any others by the recent rise in prices and that much of the burden arising from the extension of the new policy of protection which had been recently initiated was sure to fall on them, it may be argued that there was *prima facie* a good case for any step tending to promote the interest of the middle and the lower middle classes. But the general rise of prices to the extent of 12½ per cent, feared by the Majority as certain to result from the reduction of the ratio to 1*s.* 4*d.*, assumed what really had not been proved, namely, that prices had already completely adjusted themselves to 1*s.* 6*d.* Further, even taking complete adjustment for granted, there were reasons for hoping that the full rise of 12½ per cent would not have actually manifested itself because it would have been counteracted to some extent by the unmistakable tendency of world prices to fall.

The strongest point made by the Majority was that the higher rate had enjoyed an unbroken existence for over a year and that therefore presumably a good deal of adjustment had already taken place. Even here, however, it may well be objected that the period of 'over a year' was not long enough for substantial adjustment, and that the presumption was against, rather than in favour of, such adjustment having taken place.[2]

(ii) *Critical examination of the case for* 1*s.* 4*d.*—It can equally well be

[1] See *Hilton-Young Commission Report*, pars. 178-9.

[2] In his Minute of Dissent (par. 80) Sir Purshotamdas Thakurdas referred to the view of Keynes that, in a country like the United Kingdom, about two years is the necessary period for readjustment to a ten per cent variation in exchange and that, if this is the case in

shown that the champions of 1*s.* 4*d.* did not always use arguments which were entirely unexceptionable. For example, they laid much stress on the excessive deflation of currency indulged in by the Government in order to maintain the ratio at 1*s.* 6*d.*. But if the deflation was as great as it was made out to be, it must have substantially brought down the general level of prices. To admit a considerable fall of prices, however, was to admit a more or less complete adjustment to the higher ratio.

The opponents of the higher ratio dwelt on the increase in the burden of rural indebtedness caused by it, but they did not take into account certain compensating advantages accruing to the agriculturist from cheaper implements and, in general, a decreased cost of production. They also failed to take cognizance of the fact that a good deal of the agricultural debt is incurred in kind and not in money, and that part of it also consists of short-period obligations.[1]

By far the strongest argument in favour of the old ratio was that stabilization at 1*s.* 6*d.* appeared like wanton tampering with the standard of value. Even if we choose the most favourable ground for the advocates of 1*s.* 6*d.* and assume that economic disturbance would have been greater under 1*s.* 4*d.*, the evils proceeding from this disturbance would have been more readily acquiesced in by the people. As it was, the departure from the old ratio vastly increased the number of currency malcontents and presented critics of the Government with a fresh grievance, so that the new ratio took the place of the drain theory as an all-sufficient explanation for every conceivable evil.

The economic historian of the future will certainly not record the period that has passed since the new ratio was made effective as among the most prosperous in the annals of this country, and the fact that the country passed through very difficult times during the period of the economic depression (1929-33) and the recession (1937-8) added to the vehemence with which the Government's exchange policy was attacked. It may be argued that industry and commerce would have been in an even worse plight if the country had gone back to the old ratio. This, however, takes for granted that more than 50 per cent of the transition to the 1*s.* 6*d.* ratio had been accomplished, which is precisely what requires to be proved. We have already suggested above that the evidence adduced in support of the Commission's view that the major part of the adjustment was already over, when they began their deliberations, is far from convincing. We have gone further and argued that even if the reversion to 1*s.* 4*d.* had meant slightly greater disturbance—and this is the utmost that need be conceded by anyone impartially weighing all the evidence produced—it would have been worth while risking it for the sake of the old standard. It should, however, be quite clear that the longer the period during which the new rate[2] was maintained, the stronger the presumption that conditions had settled down to it in a preponderant degree and the weaker the case for restoring the old ratio.[3]

a country the bulk of whose trade is external, the period required must be undoubtedly longer in a country like India whose internal trade is much greater in volume than her foreign trade.

[1] See Sir J. C. Coyajee, *India's Currency, Exchange and Banking Problems*, p. 10.

[2] The new rate (1*s.* 6*d.*) was placed upon the statute book by the Indian Currency Act of March, 1927. See §19 below.

[3] See, however, §§20, 23 and 25 below.

§17. Subsequent development of the ratio controversy (April 1927 to September 1931).—Owing to the crisis which blew over from America in the autumn of 1929, prices of commodities and securities collapsed throughout the world, and Indian securities shared the common fate. The natural nervousness of investors in these circumstances showed itself in reluctance to invest and the phenomenon of the flight of capital from the rupee. This tendency was further emphasized by the strong political agitation in India. The world economic depression was marked by a steep fall of prices, especially in the case of agricultural countries like India whose exports of raw materials were badly hit.

In these circumstances the Government found themselves compelled, to maintain the exchange at 1*s*. 6*d*., to take special financial measures such as currency contraction, the issue of Treasury Bills to Exchange Banks and other purchasers so as to control credit in the interest of the firmness of exchange, raising the bank rate of the Imperial Bank of India, etc.

The opponents of the 1*s*. 6*d*. ratio argued that since so much management and manipulation was found necessary to maintain it till as late as 1931, long after the new ratio was put upon the statute book (in March 1927), conditions had not become adjusted to it and it was still desirable to go back to the old ratio of 1*s*. 4*d*. Another circumstance interpreted as showing the unsuitability of the ratio was the difficulty experienced by the Government in securing the necessary sterling funds for remittance to London in the years 1929-30 and 1930-1. Between November 1930 and March 1931 the situation became even worse. Not only were the Government unable to purchase sterling, but they had actually to sell sterling to the extent of £5·6 millions to meet the demand that had arisen. Later again they had to sell Reverse Councils of the value of £14 million between June and September 1931 in support of the rupee.

It is impossible to single out the new ratio as a factor of prime importance in explanation of the slump during the world depression. Allowing for a certain necessary time-lag we should expect that any economic dislocation that may have been due to the ratio would have shown itself at its worst in the years nearest to the time when it was established and that it ought to be less and less serious as we travel further and further away from this point.

A radical change in circumstances may of course at any moment call for an alteration in the ratio, however thoroughly well adjusted it may have been at one time. And certain circumstances had arisen since England had left the Gold Standard in September 1931 in view of which it was possible to contend that a reconsideration of the matter had again become necessary.[1] From a strictly *economic* point of view, however, the question can no longer be regarded as that of a choice between 1*s*. 6*d*. and 1*s*. 4*d*. A possible abandonment of the present ratio need not necessarily mean a reversion to the old ratio of 1*s*. 4*d*. We should be quite prepared to find that if a thorough and unbiased review of the position indicates the necessity of changing the present ratio (namely 1*s*. 6*d*. sterling), it might also indicate some ratio other than 1*s*. 4*d*. as the most suitable in the altered circumstances.

§18. The Government accept the Hilton-Young Commission Report.

[1] See §§20 and 25 below.

—On 16 January 1927, the Government published three Bills embodying the Commission's recommendations. These were (i) a Bill to establish a gold standard currency for British India and constitute a Reserve Bank of India, (ii) a Bill to amend the Imperial Bank Act, 1920, and (iii) a Bill further to amend the Coinage Act of 1906 and the Paper Currency Act of 1923 for certain purposes, and to lay upon the Government certain obligations in regard to the purchase and sale of gold (later altered to sterling) exchange. The first two Bills will be referred to in our chapter on Banking. Here we are concerned with the third Bill which was moved in the Assembly by Sir Basil Blackett on 7 March 1927. The Finance Member explained the principle of the Currency Bill, which was that the time had arrived to stabilize the rupee and that the Bill proposed for the first time in Indian financial history to impose a statutory liability on the Currency Authority to maintain the rupee at the ratio thus fixed. Before the war there had been no statutory provision for preventing the rupee from falling below a fixed ratio of gold, so that the link between the rupee and gold was imperfect. Sir Basil Blackett pointed out that the Bill was no more than a transitional measure intended to be operative only during the period between its passing and the time when the Gold Standard and Reserve Bank Act should come into operation. The Bill was bitterly opposed at every stage, but finally became law and came into operation from 1 April 1927.

§19. **The Currency Act of March 1927.**—The new Act established the ratio of 1*s.* 6*d.* by enacting that the Government would purchase gold in unlimited quantities at the Bombay Mint at the price of Rs. 21-3-10 per tola[1] of fine gold in the form of bars containing not less than 40 tolas (15 oz.). Holders of legal tender currency (silver rupees and paper notes) were entitled to obtain on application to the Controller of Currency, Calcutta, or the Deputy Controller of Currency, Bombay, either gold at the Bombay Mint, or at the option of the Government, sterling for immediate delivery in London, provided they demanded and paid for an amount of gold or sterling of not less value than 1,065 tolas (400 oz.) of fine gold at the rate of Rs. 21-3-10 per tola of fine gold.[2] Sterling was to be sold at the same price after allowing for the normal cost of transport from Bombay to London. A rate of 1*s.* 5 49/64*d.* was notified as the Government selling rate for sterling to meet these obligations.[3] On 1 April 1927, when the Indian Currency Act of 1927 came into force, conditions governing acceptance of gold at the Bombay Mint were published.

By the same Act sovereigns and half-sovereigns ceased to be legal tender in India,[4] but an obligation was placed on the Government to receive these coins at all currency offices and treasuries at bullion value reckoned at Rs. 21-3-10 per tola of fine gold, that is Rs. 13-5-4 per full-weight sovereign. In spite of the fact that these coins ceased to be legal tender there was an appreciable import of sovereigns into India. The Currency Act of 1927 established what may be called a Gold Bullion *cum* Sterling Exchange Standard in India. Since the Government had the option of giving sterling and not gold, strictly speaking the standard thus established

[1] The parity of the exchange was thus 8·47 grains of fine gold per rupee.

[2] See L. C. Jain, *Monetary Problems of India*, p. 34.

[3] *Report of the Controller of Currency* (1926-7), p. 3.

[4] It may be pointed out here that the British Gold Standard Act of 1925 did not demonetize gold coins, although the right of free coinage was withdrawn.

was a Sterling Exchange Standard although in practice it worked as a Gold Exchange Standard until 20 September 1931, sterling till then being at par with gold. (See §20 below.) 'If the Government chose to exercise the other option open to them of offering gold in exchange for rupees, India would have had, in point of fact, if not in law, a gold standard. Thus the standard of 1927, though a sterling exchange standard, was capable of becoming a gold standard, and certainly indicated that the gold standard was the ideal of the Government.'[1] The sterling exchange standard of 1927 was, no doubt, superior to the earlier exchange standard since it established a statutory gold parity for the rupee and imposed a statutory obligation on the Government to buy gold and sell gold or sterling at fixed rates. In other respects, however, it still had all those deficiencies which we have already pointed out (see §§1-6).

§20. **Divorce between sterling and gold and its reactions in India.**—The monetary standard established by the Act of 1927 did not have a fair chance of being converted into a genuine gold (bullion) standard owing to the dramatic developments which the world currency and exchange situation underwent in consequence of the breakdown of the gold standard in Great Britain and several other countries. Great Britain left the gold standard with effect from 21 September 1931. On the same date the Governor-General promulgated an Ordinance suspending the operation of the obligation to sell gold or sterling, which was however followed by a declaration by the Secretary of State announcing his decision to maintain the rupee at 1*s.* 6*d.* sterling. On 24 September the Governor-General promulgated yet another Ordinance, called the Gold and Sterling Sales Regulation Ordinance, repealing the previous one and thus technically restoring the provisions of the Currency Act of 1927 but seeking in practice to exercise an effective control over the sale of sterling, and thus introducing a controlled sterling exchange standard. Under the terms of the new Ordinance, sterling was to be sold not to all and sundry but only to recognized banks, which were expected to realize their responsibilities in the matter. It was to be sold at the rate previously in force, i.e. 1*s.* 5 49/64*d.* per rupee, for financing normal trade requirements and contracts completed before 21 September, and for reasonable personal and domestic purposes. It was not to be sold for financing imports of bullion or speculative exchange transactions. These precautions were taken in order to avoid undue strain on the Government's gold and sterling resources and to prevent the flight of capital from India. This control was to be exercised through the agency of the Imperial Bank. The rupee, being linked to sterling, inevitably shared in the depreciation and fluctuations of the latter in relation to gold and to currencies still based on gold, such as the dollar and the franc. The rise in the value of gold in terms of sterling as reflected in the sterling-dollar cross-rate meant a corresponding rise in its value in terms of rupees. The price of gold in the bullion market, which was Rs. 21-13-3 per tola towards the end of August 1931, rose to as much as Rs. 29-2-0 in December 1931.[2] The stimulus of high prices and partly also the prevailing economic distress in rural areas induced people to sell their gold. About Rs. 50 crores worth of gold

[1] Jain, op. cit., p. 35.

[2] In subsequent years the price of gold rose still higher, being Rs. 36-13-3 per tola on 7 March 1935—the highest recorded price since the abandonment of the gold standard by Great Britain. *Annual Market Review* (Premchand Roychand & Sons), 1935, p. 80.

was thus exported from India between the end of September 1931 and the end of February 1932. This enormous export of commercial gold had a favourable reaction on India's balance of trade. The supply of sterling created against the gold exports came to be in excess of the demand for it, and rendered restrictions on the sale of sterling by the Government superfluous. This enabled the Government to repeal the Gold and Sterling Sales Regulation Ordinance on 31 January 1932. Thus technically the Currency Act of 1927 was fully restored, but that did not make any difference in practice. The Secretary of State's declaration that the rupee should be maintained at 1*s*. 6*d*. sterling actually remained in force, and India's standard continued to be the sterling exchange standard.

This phase of the Government's currency and exchange policy gave rise to acute controversy. Apart from the resentment caused in the country by the fact that the Secretary of State had made a vital announcement of a new currency policy without consulting the Indian legislature, the criticism levelled against the Government fell under two heads: (i) the linking of the rupee to sterling at 1*s*. 6*d*. and (ii) the uncontrolled export of gold from India.

§21. **The linking of the rupee to sterling at 1s. 6d.**—The following were the main arguments advanced in support of the policy adopted by the Government. (i) The choice for the Government was between achieving comparative stability by linking the rupee with sterling and risking complete instability by allowing the rupee to drift, without any attempt to regulate its exchange value. The former of these alternatives was clearly to be preferred. (ii) Though the Hilton-Young Commission had voted against linking the rupee to sterling, this advice, though sound enough in normal times, could not be followed in an emergency situation. India had annually £32 millions sterling obligations and a sterling loan of £15 millions was maturing early in 1932. The difficulties in raising the necessary funds for these purposes would have been almost insuperable unless the rupee was linked to sterling. Without a stable sterling rupee the Indian budget would become a gamble in exchange. (iii) So long as India remained a debtor country the risk of leaving the rupee alone and thus taking a sudden leap into the unknown was much greater than in the case of creditor countries like England. (iv) India's trade with England and other countries on a sterling basis represented no inconsiderable proportion of her total international trade. It was, therefore, advisable to secure a stable basis at least for this trade. (v) There would be a welcome, although temporary, stimulus to the export trade of India with the gold standard countries owing to the depreciation of the rupee in relation to gold. (vi) It did not lie in the mouth of those critics of the Government who were anxious to stabilize the rupee at a lower value than 1*s*. 6*d*. to complain when the rupee at the current cross-rate was worth considerably less than 1*s*. 4*d*. gold.

The main arguments on the other side were as follows : (i) By linking the rupee to sterling India was being made to share in the fluctuations of sterling, which reflected economic conditions in England and not in India. By leaving the rupee alone, on the other hand, there would also be instability no doubt but this would reflect conditions in India itself. India was thus deprived of the freedom to adopt a rate of exchange suitable to her own requirements in respect of foreign trade and the internal price level. (ii) Against the advantage to exports to gold

standard countries like the U.S.A. must be put the disadvantage to imports from such countries, as also the fact that the linking of the rupee to sterling constituted a form of Imperial Preference granted to England. (iii) There was the danger that the Government's attempt to stabilize the rupee even at the lower gold value of 1*s*. 6*d*. might involve the dissipation of the remaining gold reserves of the country. (This danger was not however serious owing to the arrangements made by the Government to conserve them, such as restrictions on the sale of sterling to the public.) (iv) Finally it was argued that though the rupee depreciated in terms of gold it continued to be overvalued in sterling at 1*s*. 6*d*., while the yen and other currencies were devaluated in sterling. India was thus placed at a disadvantage.[1]

§22. **The export of gold from India.**—The total amount of gold exported from India after Great Britain went off the gold standard in September 1931 amounted to Rs. 351·40 crores at the end of January 1940. This was widely interpreted to mean the wastage of India's gold resources, the wreckage of the indigenous banking system, and a drain on the accumulated savings of generations. It was argued that the adventitious aid of gold exports concealed overvaluation of the rupee at 1*s*. 6*d*. and that the uncontrolled export of gold made it impossible for the country ever to reach the goal of the gold standard. It would not be easy for India to buy back the gold she was exporting on such an unprecedented scale. Unlike India every other country in the world was sitting tight on its gold and was trying to add to its stock of gold whenever possible. Finally, it was contended that the gold that was exported was 'distress gold', and that the people were living on their capital—a process which could not continue indefinitely. There was a good deal of agitation in the country in favour of either complete prohibition of the gold exports or the levy of an export duty. It was further proposed that the Government (or the Reserve Bank of India) should themselves purchase this gold at a price regulated by the dollar and franc-sterling cross-rates and thus strengthen their gold reserves.[2]

In support of the Government's policy,[3] however, it was argued that the gold that had been sold was not currency gold but commercial gold, a commodity serving as a store of value. It was sold because the owners were realizing a profit on it. It was also sold because many people found themselves compelled to turn their assets into ready cash for meeting their obligations. The fact that distress prevailed was deplorable. But obviously the interest of the distressed person lay in unrestricted freedom being allowed to him in disposing of his gold in the dearest market. It should further be borne in mind that gold in the hands of private

[1] For an illuminating discussion of the two sides of the gold export controversy in India see articles by Professors B. R. Shenoy and B. P. Adarkar in the *Indian Journal of Economics*, July 1935 and January 1936.

[2] Cf. Sir M. Visvesvaraya, *Planned Economy for India*, p. 184.

[3] Sir James Grigg during the course of his Budget Speech (1935) expressed the Government's point of view as follows: 'I cannot share the views which attribute to gold exports some abstruse monetary significance nor do I find in them an indication that India is being driven by distress to part with her last reserves. Indeed, I can see no sufficient reason for placing them in a different category from exports of any other commodity of which India has a surplus, and I, therefore, find no cause for regret or alarm in the fact that India is still able to obtain so handsome a profit from the reserves of gold which had been accumulated in previous years.'—*Central Budget for* 1935-6, par. 23.

persons cannot be obtained by the Government for any purpose unless the price offered is sufficiently attractive to the owners. Further, the gold that had been exported was only a fraction of the total store of gold in India, which had been estimated at £750 million. The well-known hunger for gold of people in this country was not likely to disappear suddenly, so that sooner or later it would be bought back when prices returned to normal. In the meantime its sale was oiling the wheels of trade and helping productive enterprises. It had a favourable effect on the balance of trade and had converted inert metal into live currency. It produced a welcome effect also on the Government's financial position so far as the sterling remittances to the Secretary of State and the strengthening of the sterling reserves were concerned. It had also helped to keep the rupee-sterling exchange stable at 1*s*. 6*d*. and had greatly improved the position of India's credit in the city of London and the world. The exports of gold brought about an increase in the note circulation, holdings of postal cash certificates, postal savings deposits and bank deposits, generally created cheap money conditions in the money market and assisted business recovery in the country.

As regards the suggestion for a duty on gold exports, the burden would fall on the ultimate seller of gold, who was the agriculturist. The Government should not try to restrict the free sale of gold unless there were very strong reasons to fear that the policy of non-intervention would come in the way of equipping the Reserve Bank of India with adequate gold reserves having regard to the country's requirements.

§23. **The ratio question and the Reserve Bank Bill.**—We have already pointed out how the rupee was linked to sterling in September 1931 and how the Indian monetary system again came to be worked as a sterling exchange standard, although technically the Currency Act of March 1927 still remained on the statute book. The whole question of a suitable monetary standard and ratio once more became the subject of acute controversy in connexion with the nature of the exchange obligations to be imposed upon the proposed Reserve Bank of India. The London Committee on the Reserve Bank Legislation stated in its Report (August 1933): 'The questions which arise in connexion with the exchange obligations to be imposed on the Bank present special difficulty in existing circumstances. In the present state of monetary disorganization throughout the world, it is impossible to incorporate in the [Reserve Bank] Bill provisions which would be necessarily suitable when monetary systems generally have been re-cast and stabilized. In these circumstances we consider that the only sound course for India is to remain on the sterling standard. On this basis the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee-sterling ratio existing at the time when the Bill is introduced. This statement does not, however, imply any expression of opinion on the part of the Committee on the merits or demerits of the present ratio. The ratio provisions in the Bill are designed to make it clear that there will not be any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act. . . . We are all agreed that it should, in any case, be made clear in the preamble that the whole question of the monetary standard best suited to India will have to be reviewed when the international situation has clarified itself and become sufficiently stable to make it possible to frame more permanent

provisions' (par. 19). As the Committee themselves admitted, a considerable majority of Indian delegates felt it their duty to record their view that a suitable exchange ratio was one of the essential factors for the successful working of the Reserve Bank. They pointed out that considerable changes had occurred in the currency bases and policies of almost all the countries of the world in the last few years.[1] In their view it was for the Government of India and the Legislature to examine these and other considerations with a view to ensuring that the minimum possible strain was placed on the currency system of India. Sir Purshotamdas Thakurdas in a separate note put forward a strong plea for the review of the ratio before the inauguration of the Reserve Bank and held up the example of Australia, New Zealand and the United States, which had devalued their currencies with a view to raising prices and improving their balances of trade. He referred to the strong opinion in India that a lowering of the existing ratio of 1*s.* 6*d.* would give much relief to the cultivator. There was a similar cleavage of opinion among the members of the Joint Select Committee to whom the Reserve Bank Bill was referred in September 1933. The majority approved of the London Committee's recommendation of continuing the *status quo* and leaving the question of permanent measures to the future. When the Reserve Bank Bill, as reported upon by the Select Committee, came before the Assembly in November 1933, several amendments relating to the ratio clauses were tabled by members. While the Bill was on the anvil of the Legislature a country-wide agitation against the 1*s.* 6*d.* ratio was carried on by the Indian Currency League.

§24. **The exchange obligations of the Reserve Bank of India as the new currency authority.**—The ratio clauses (40 and 41) as finally embodied in the Act (1934) gave effect to the recommendations of the Majority of the London Committee on Reserve Bank Legislation. The Reserve Bank was required to maintain the existing ratio (1*s.* 6*d.* sterling) between fixed upper and lower points as though the rupee was on a gold basis. By clause 40, the Bank was required to sell sterling to any person on demand at its offices in Bombay, Calcutta, Delhi, Madras or Rangoon on payment in legal tender currency, for immediate delivery in London, at a rate not below 1*s.* 5 49/64*d.* for a rupee. This provision was meant to prevent the rupee from falling below 1*s.* 5 49/64*d.*, which corresponded to the lower point of the rupee (i.e. 1*s.* 6*d.* *minus* the cost of laying down in London this amount of sterling). On the other hand, clause 41 made it necessary for the Bank to buy sterling from any person for immediate delivery in London, at a rate not higher than 1*s.* 6 3/16*d.* for a rupee, which corresponded to the upper point of the rupee (viz. 1*s.* 6*d.* *plus* the cost of importing this amount of sterling from London to Bombay). It was also laid down that no person should be entitled to demand to buy or sell an amount of sterling less than ten thousand pounds.[1]

The Reserve Bank Act thus legalized the existing ratio and provisionally established in India a sterling exchange standard of an improved type, in so far as there was a definite statutory parity prescribed for the rupee and an obligation under law imposed upon the Reserve Bank to maintain the rupee at this parity.

[1] The Reserve Bank of India (Amendment) Act of April 1947 repealed clauses 40 and 41 and there is therefore no longer in existence the statutory obligation on the Reserve Bank to buy and sell sterling at stipulated rates.

Also the two separate Currency Reserves were abolished and the Reserve Bank of India was appointed as the new currency authority to issue notes, hold the Currency Reserve and work the currency system, thus replacing the Government who had previously taken upon themselves monetary duties.[1] Nevertheless even this improved sterling exchange standard remained open to some of the criticisms pointed out earlier in the chapter (§§1-6). The preamble to the Reserve Bank Act incorporated, however, the suggestion of the London Committee that the question of the monetary standard best suited to India should be considered when the international monetary situation had become sufficiently clear to make it possible to frame permanent measures.

§25. **Pros and cons of devaluation.**[2]—The above arrangement failed to give satisfaction to the currency critics of the Government and the advocates of devaluation among the ranks of the Indian business community. (See also §23.) For example, Mr Manu Subedar, President of the Indian Merchants Chamber and Bureau, Bombay, suggested a review of the ratio with a view to raising prices and giving relief to the cultivator. The Finance Member replied that he would be no party to any 'monkeying' with the present ratio. While welcoming a healthy rise in the prices of primary products in India, he pointed out that the effect of a lowering of the ratio would be to leave agricultural prices where they were—or even to lower them—and to raise the prices of manufactured articles. Owing to the existing disparity between agricultural and other prices such a result would lead to a further worsening of the position of the cultivator. Apart from this, a lowering of the ratio would in the opinion of the Finance Member make the budgetary problems of India, already sufficiently difficult, quite insoluble. (The Budget surpluses of the few years preceding the 1939-45 war however went against this contention.) Moreover, cheap and plentiful money, which already existed and which was the normal and recognized means of raising prices, had in India tended to create unhealthy speculative conditions, and this seemed to indicate that for an agricultural country cheap money is not in itself sufficient to raise prices. In the view of the Finance Member there was needed in addition a general agreement among the nations of the world to stabilize their currencies and to reduce the restraints upon international trade. The controversy regarding devaluation of the rupee flared up in October 1936, owing to the reactions in India caused by the devaluation, in September, of the franc and the other currencies of the gold bloc countries. Advocates of devaluation raised the issue on the floor of the Legislative Assembly by moving a motion of adjournment which was only defeated by the casting vote of the President.

In favour of devaluation it was argued that a realignment of Indian currency was essential in view of the devaluation of the franc, and other currencies, that the rupee was overvalued at 1*s*. 6*d*. sterling, and that devaluation would not only raise prices of primary produce in India but also help to revive the export trade and create a favourable trade balance, thus making exports of gold unnecessary.

[2] See ch. xi.

[3] For a detailed and critical treatment of the controversy regarding devaluation, see B. N. Adarkar, *Devaluation of the Rupee* (1937).

Devaluation of the rupee, it was pointed out, would give relief to the farmer debtor, would stimulate the industrial development of the country and generally assist business recovery.

On the other hand, opponents of devaluation argued that for India to devalue her currency at that juncture would constitute a breach of the Tripartite Monetary Agreement (1936) signed by the U.K., the U.S.A., and France, and would adversely affect the prospects of world stabilization of currencies. India's action in devaluing the rupee would provoke retaliation elsewhere and revive the currency war. There was no need to devalue the rupee further since it had already been devalued by about 40 per cent in relation to gold by being linked to sterling, enabling India to share in the economic recovery of the sterling area. The rupee could not be said to be overvalued since there were no symptoms of an overvalued currency, viz. budget deficits, high money rates, loss of gold from currency reserve, falling trade balances and deflation of currency. Devaluation of European currencies did not much affect India and in any case she was armed under the Indian Tariff Act (1894) to protect her industries against dumping caused by depreciation of foreign currencies. As regards the much-desired revival of our export trade, devaluation was likely to worsen the situation by provoking retaliation. The real trouble lay in aggressive economic nationalism abroad and restrictions on trade, and the proper solution was to promote international goodwill, peace and stabilization of currencies. Lastly, it was pointed out that it would be unwise for India to indulge in devaluation and thereby upset the delicate fabric of the Otto Niemeyer (Financial) Award on the eve of provincial autonomy under the new constitution.

The weakening of the exchange value of the rupee, following a decline in the exports of merchandise and gold as a result of the economic recession of 1937-8, served as an added plea for the revival of the devaluation movement. The Working Committee of the Indian National Congress took up the question of the revision of the rupee ratio. The Government of India were, however, opposed to any alteration in the statutory ratio, and declared that they were satisfied that the maintenance of the existing value of the rupee was required in the interests of India and that the gold and sterling assets available for this purpose with the Reserve Bank and the Government of India were more than ample. Nevertheless the movement for devaluation gathered force and an unsuccessful attempt was made by some non-official members of the Central Legislative Assembly in September 1938 to secure the appointment of a Committee to report on the whole question of the rupee ratio and to determine a permanent basis for the Indian monetary sytem.

Following an improvement in the balance of trade the rupee exchange remained on the whole steady until December 1938, when forward exchange rates weakened, the fall being further aggravated by speculation; but the Government of India adhered to their decision to maintain the exchange at the existing statutory rate. With the revival of the seasonal activity in the export markets and the firmness in the money rates, the exchange rates steadied and improved to 1*s*. 5 31/32*d*. in March 1939. Except for a temporary sagging tendency in May 1939, the exchange rates remained steady until the outbreak of war in September 1939.[1] The war

[1] See *Reports on Currency and Exchange*, 1938-9 (par. 27) and 1939-40 (par. 23).

entirely changed the outlook, however; and the quick outflow of India's produce and Indian gold after 3 September created problems of exchange management antithetical to those of the year before. The rupee, which was said to be overvalued in 1938, was considered undervalued after the Allies' declaration of war on Germany.[1]

§26. **International Monetary Fund and par value of the rupee.**—The Government of India decided to adhere to the Bretton Woods Agreements and to secure for India the advantages and benefits of original membership of the International Monetary Fund and the International Bank for Reconstruction and Development by signing the two Agreements before 31 December 1945.[2]

Informed opinion in the country was heavily in favour of India's participation in these important international organizations not only for the material benefits expected but also for reasons of India's international status and prestige. Government therefore felt justified in taking action in advance of the approval of the Legislature, so as not to lose the advantages of original membership, and the sanction was subsequently obtained when the matter was placed before the Legislature at its next session. Among the advantages of original membership were the following: (i) The terms and conditions of membership, including India's quota, were known whereas membership after 31 December 1945 would have been subject to such terms as might have been prescribed by the Fund and the Bank. (ii) By joining as an original member India was certain of securing a seat on the executive directorship from the very outset whereas later India would have had to wait for that privilege for at least two years.

On the advice of the Reserve Bank as well as in response to strong public opinion, Government also notified the Fund that there was to be no change in the par value of the rupee. The following are extracts from the press communiqué issued in this connexion in December 1946.

'Pursuant to Article 20, Section 4 (*a*) of the Articles of Agreement of the International Monetary Fund, the Government of India were requested on 12 September 1946, to communicate to the Fund on or before 12 October 1946, the par value of the rupee expressed in terms of gold or U.S. dollars based on the rates of exchange prevailing on 28 October 1945, which was the sixtieth day before the coming into force of the Agreement. On the basis of the exchange rates prevailing on that date, namely, Re. 1 = 1*s.* 6*d.* and £1 = $4.03, and one fine ounce of gold = $35, the par value of the rupee in terms of gold came to 0·0086357 ounces of fine gold and this was duly communicated to the Fund. . . .

'The Government of India, having regard to all the relative circumstances and in consonance with the vast majority of the opinions received, have decided that no change is called for in the par value of the rupee. While intimating this decision, the Fund has been informed that in the interests of accuracy, the par value of the rupee, instead of being expressed in terms of ounces of gold as previously communicated, should be expressed in terms of grains troy of gold as follows:

' Using gold as the common denominator, one rupee is to be regarded as

[1] See *Annual Market Review* (1939), p. 18. See also §28.

[2] The actual date on which the Agent-General for India in Washington signed the Agreements on behalf of India was 27 December 1945.

having a theoretical gold content of 4·145142857 grains of fine gold; this weight of gold producing a rupee-dollar rate of Rs. 3·3085194 per U.S. dollar and parity price of gold of Rs. 2,115-12-9·25056 per ounce of fine gold.'[1]

The case for not changing the par value was mainly based on the following considerations :

(i) Having regard to the uncertainties and transitional character of the prevailing economic conditions, it was not possible to say with confidence what particular ratio was likely to be most suitable. It was therefore desirable to postpone the question of changing the ratio until conditions became more stable.

(ii) Although the very much higher price-levels in India as compared to those in Britain and the United States seemed to indicate the necessity of devaluing the rupee, the chances were that in the near future the two sets of prices would come closer together by a fall in Indian prices and a rise in U.S. and U.K. prices.

(iii) Devaluation would cause a further rise in the already excessively high level of Indian prices and would hamper the widely advocated policy of bringing about, by means of intensified production and freer imports, an appreciable fall of prices from the fantastic heights which they had reached.

Devaluation would also involve a rise in the rupee prices of the vast amount of capital goods and equipment which India was hoping to import from foreign countries in order to carry out her ambitious programme of industrialization and would therefore act as a handicap to industrialization.

(iv) Under the scheme of the Fund it would always be possible if necessary in future to secure a suitable change in the ratio. A unilateral change in the rate could be made initially by a member-country up to 10 per cent par value and a further alteration, to correct 'fundamental disequilibrium', could be made later with the permission of the Fund.

§27. **The rupee devalued (September, 1949).**—On 19 September 1949 the British Government announced the devaluation of the pound sterling. The official ratio of pound-dollar exchange had been £1 = $4·03. The new ratio now decided upon was £1 = $2·80. The Indian rupee followed suit with the result that while the parity with sterling remained at 1*s*. 6*d*. the rupee came to be worth 21 instead of 30·225 U.S. cents.[2]

Devaluation of the pound sterling was the signal for devaluation of their respective currencies by no less than 24 other countries, some inside and others outside the sterling area. The decision of the United Kingdom to devalue sterling, followed by similar devaluation by a number of other countries, compelled India

[1] This however was not merely an improvement on the pre-1914 system of international gold standard. Movements of capital and gold will no longer have the same significance as they had under the pre-1914 system. One of the reasons for this is that the Central Banks have now perfected the technique for neutralizing such movements. Moreover it will now be the responsibility of the International Monetary Fund to take steps to maintain exchange stability by coming to the rescue of countries in temporary need of foreign exchange and by correcting fundamental disequilibria in the balance of payments position of member-countries. In all this procedure gold will not play its old-time decisive role.

[2] If one pound is equal to 280 cents, then 1*s*. 6*d*. which is the par value of the rupee is equal to 21 cents. The par value in grammes of fine gold per rupee is now 0·186621, giving the value of Rs. 166·6666 per fine ounce of gold.

to take similar action: India's foreign trade is largely with sterling area countries and if the rupee had been allowed to appreciate against sterling, Indian exports would have been even dearer than they are, increasing the difficulty in selling them in our usual markets. Shrinking exports would in course of time have meant shrinking imports, which would have been detrimental to our economy. Our plans of economic development and industrial expansion would have been difficult to implement owing to shortage of essential imports. Moreover the general expectation in other countries that India would not be able to avoid devaluation in the face of the action taken by the United Kingdom would have acted as a powerful psychological barrier to any transactions at the old rates of exchange, and trade would have come to a standstill. India therefore felt compelled to follow the other sterling area countries and to devalue the rupee as a defensive measure. The Government hoped and expected that such devaluation would have little effect on the prices of commodities of essentially indigenous origin which mainly enter into our cost of living. In particular, as there were not going to be any further imports of food grains from the dollar area during the current year, it was expected that food prices would not be affected and, since we are on the whole more dependent for trade on the sterling area than the dollar area, the general price level or the cost of production would not increase and the internal price of commodities would not be affected. Any tendency for prices to rise could moreover be countered by the exercise of regulatory public authority and by rationalizing and increasing production.

Pakistan, alone of the countries in the sterling area, decided against devaluation of her currency on the ground that conditions justifying devaluation such as deep-seated disequilibrium in the country's balance of payments did not exist in Pakistan and that her exports, consisting as they did almost entirely of raw materials, did not admit of any appreciable expansion by the device of devaluation. The decision not to devalue would not only not cause any harm to the country's economy but would on the contrary bring certain important gains. It would mean cheaper imports which would have a welcome effect on the general cost of living in the country as a whole and especially in Eastern Pakistan where marked inflationary tendencies had been visible for some time. Capital goods and essential raw materials could be secured at much more favourable prices from countries which had devalued and industrial development would consequently be facilitated.

Pakistan's unwillingness to follow India's example in the matter of devaluation added to the growing tension between the two countries. Pakistan insisted on payment for her exports to India of jute and other goods at the new rate, which meant that India was now required to pay Rs. 144 where she previously paid Rs. 100.[1] India refused to pay at this inflated rate as she felt convinced that eventually Pakistan would also have to devalue her currency by the compulsion of economic forces. This led to an almost complete stoppage of trade relations between the two countries and serious embarrassment and heavy losses to both.

[1] 100 Indian rupees at the new rate are equivalent to 2100 U.S. cents, whereas 100 Pakistani rupees at the old unchanged rate are equivalent to 3022 cents = about 144 Indian rupees.

§28. **Effects of World War II on Indian currency and exchange.**[1]—The initial effects of the war on Indian economy, despite the inevitable dislocation it entailed in many spheres, were on the whole beneficial to the country; production, prices and foreign trade received a stimulus, and the prospects of the agriculturist improved. The Indian currency and the financial system withstood the strain remarkably well; confidence in the paper currency was generally maintained despite the increased demand in certain centres for the conversion of notes into coin, and after an initial fall due to uncertainty, bank deposits and security prices generally recovered. The rupee-sterling exchange tightened in consequence of the war, as is shown by the fact that 1*s*. 6*d*. after a long time materialized as the rate for December-February (1940) T.T. The Reserve Bank of India was also successful in purchasing large quantities of sterling for Home treasury requirements and generally for strengthening the external assets of the currency reserve (see §30 below and ch. xi). This stands in marked contrast with the weakening of the rupee-sterling exchange on the outbreak of the war of 1914-18 and the sale of sterling by Government in order to prop up the rupee ratio.

While the rupee remained firm in relation to sterling it depreciated in relation to the dollar, yen and the Continental currencies (the exchange quotations for leading Continental currencies disappeared owing to their being occupied or surrounded by Germany) following the slump in the pound. With the pegging of sterling to the dollar at \$4·02 to £1, the rupee-dollar exchange was steady round about Rs. 332 per 100 dollars. In response to the increased trade activity and rise in commodity prices, which followed the outbreak of the war, the Reserve Bank of India expanded currency in the form of both bank notes and rupee coin to the extent of Rs. 48 crores between September and the end of December 1939. The active average circulation of notes increased from Rs. 186·06 crores in September 1939 to Rs. 237·29 crores in June 1940. This was effected against large purchases of sterling and considerable purchases of Treasury Bills by the Reserve Bank. It is not surprising, therefore, to find that the rupee-sterling exchange was very steady during this period.

§29. **Exchange control.**—On the outbreak of the war, the Central Government delegated to the Reserve Bank the authority under the Defence of India Ordinance to administer the regulations relating to the control of dealings in coin, bullion, securities and foreign exchange.

All dealings in foreign exchange had to be transacted through authorized dealers, and the Exchange Banks and certain Indian joint-stock banks were licensed as such. No restrictions were placed on the purchase and sale of Empire currencies with certain exceptions, while the purchase and sale of non-Empire currencies was restricted to genuine trade purposes, travelling expenses and personal remittances. The policy of exchange control was to ensure that all foreign exchange transactions in India were done on the basis of the rates quoted by the London Exchange Control combined with the current rupee rates for sterling. Control was also established over the purchase of securities from foreigners, and export of securities could not be effected without the previous permission of the Reserve Bank. These

[1] See *Annual Report of the Reserve Bank of India* (February 1940, pp. 14, 23-4; August 1940, pp. 11-12, 18), and the *Report on Currency and Finance* (1939-40), pars. 23-4.

measures were intended to prevent export of capital from India and to check speculation in exchange, which is generally encouraged by war conditions.

The exchange control regulations were gradually tightened as need arose. An important development was the institution on 9 March 1940 of a scheme for the control of foreign exchange proceeds of exports to the hard currency countries (e.g. U.S., Switzerland, Netherlands, Belgium) in accordance with the Empire scheme formulated by the British Government. The object of the scheme was to obtain control of the foreign currency proceeds of exports, and also to see that the full proceeds of exports were received at control rates (e.g. rupee-dollar rate). This gave rise to some dissatisfaction among the business community. In general, measures of exchange control, while inevitable during the war, have had a certain degree of adverse reaction on exports and commodity prices.

In May 1940, the Government introduced a system of licensing imports for the purpose of conserving foreign exchange and ensuring that no goods, whose entry into the country was banned, were paid for prior to arrival. These restrictions, which applied to a comparatively small list of articles, were extended, in the next year, so as to cover all articles from all foreign countries with the exception of certain goods from Canada. These measures were necessary not only to secure economy in the expenditure of foreign exchange but also to conserve shipping space and productive capacity in the United States, imports from which country were increasing owing to the cessation of supplies from Europe. The deterioration in the shipping situation after the entry of Japan into the war made the supply of shipping space an overriding consideration in the issue of licences. During the year 1942-3 there was a steady fall in the amount of U.S. dollars provided in payment of imports. This was mainly due to imports such as machinery, steel, etc., which formerly required large dollar disbursements, coming forward under lend-lease. For these goods importers merely paid the Government of India directly in rupees and no transaction in foreign exchange took place. During 1944-5 there were no changes in the existing system of exchange control. Sales of the currencies outside the sterling area continued to be restricted while exports to these countries were only permitted provided the foreign currency proceeds were sold to authorized dealers in foreign exchange, thus ensuring the full conservation and mobilization of the country's foreign exchange resources. Although the system was unaltered there were modifications in the policy adopted towards demands for foreign currencies and a more liberal allotment of foreign exchange was made for purposes considered to be of high value and importance to the country.

The Government of India under their import licence system substantially increased the quotas for the import of consumer goods in 1945-6 as a means of combating inflation and to meet the accumulated and intense demand for imports. This led to a far greater volume of imports, especially from the U.S., and thus to an increased expenditure of U.S. dollars causing a sharp decrease in India's favourable balance of payments with America.

The ending of the war in 1945 did not make any change in exchange control policy. Owing to improvements in the shipping position, existing restrictions on imports from sterling-area countries which were not affected by exchange con-

siderations were relaxed, while rigid economies in the expenditure of U.S. dollars continued.

§30. **Restrictions on export and import of gold.**—With regard to gold no restrictions were placed on its transfer within 'British' India, while imports and exports were permitted only on the authority of a licence granted by the Reserve Bank. Licences for import were generally given, while those for export were also granted provided that the gold was consigned to the Bank of England or, if consigned to America, the relative dollar proceeds were sold to the Federal Reserve Bank on behalf of the Bank of England. The general idea of the regulations was to discourage gold transactions as between India and countries other than the United Kingdom. The exigencies of the war demanded the conserving of all gold resources for the use of India and Great Britain.

The war stimulated the export of gold from India, which, including purchases made by the Reserve Bank in India on behalf of its foreign constituents, exceeded Rs. 42 crores during the ten months ending 31 January 1940.

While the sterling securities in the Issue Department of the Reserve Bank of India increased from Rs. 59·50 crores on 1 September 1939 to Rs. 131·50 crores on 1 September 1940, no addition was made to the stock of gold held by the Reserve Bank of India,[1] which remained at the figure of Rs. 44·42 crores.[2]

§31. **Empire Dollar Pool and Post-War Dollar Fund.**[3]—It was customary before the war for a large number of countries (generally referred to as the 'Sterling Bloc') to hold all or almost all their foreign exchange balances in London in the form of sterling. Sterling was then freely convertible into other currencies, and therefore countries which held sterling balances could convert them at will into any currency which they happened to need in order to fulfil their international obligations. With the outbreak of the war and the increasing difficulty thereby caused in securing the convertibility of sterling, this system assumed a degree of rigidity which had not been previously contemplated. Those members of the 'sterling bloc' who continued to be members of what is now known as the 'sterling area' forwent their right to hold foreign exchange in their own custody and agreed to impose restrictions on the expenditure of foreign exchange in order to ensure that the limited resources of the sterling area of foreign currencies were utilized to the best advantage in the prosecution of the war. The whole of the sterling area's holdings of foreign exchange were held in one pool in the custody of the Bank of England and the British Treasury. As the United States dollar was the most important foreign currency in this pool, this whole arrangement came to be known as the Empire Dollar Pool instead of the Sterling Area Pool of Foreign Exchange, which more correctly describes it. In the working of the Empire Dollar Pool, the individual countries of the sterling area were given no specific allotments of the various foreign currencies which they were entitled to spend.

[1] See chs. xi and xii for an account of the disposal of some of the sterling securities for repatriation of sterling debt.

[2] The valuation of the gold holding continued to be based on the statutory rate of Rs. 21-3-10 per tola while the market rate for gold stood at Rs. 103-8-0 on 31 March 1947.

[3] This section is largely a quotation from a Press Note issued by the Government of India on 7 October 1946.

The method by which expenditure was restricted was that the countries concerned agreed not to spend foreign exchange unless the demand for which it was required was essential and could not be satisfied within the sterling area. The test of essentiality varied in strictness from time to time as the volume of the Pool increased or decreased: at the conclusion of the war, and for a considerable period before it, the test was whether a particular demand was necessary for the prosecution of the war or for the maintenance of the civil economy at a war-time level. The member-country itself was always the judge of the essentiality of its own requirement and when it certified that a particular requirement was essential and its exchange control had granted the necessary authorization, the Pool never questioned the decision taken. With the end of the war, the definition of essentiality applicable till then lost its meaning and the Government of India were much more liberal in the classification of requirements as essential than they had been in the past.

The Government of India kept an account of India's earnings and expenditure of hard currencies. From the beginning of the war up to 31 March 1946, India earned Rs. 405 crores of U.S. dollars and spent Rs. 240 crores, having a net surplus of Rs. 165 crores. Against this has to be set off the fact that India spent more than she earned, to the extent of Rs. 41 crores, of other hard currencies, namely, those of Canada, Sweden, Switzerland and Portugal. India's net contribution to the Pool was therefore about Rs. 124 crores till the close of the year 1945-6.

During the quarter ending June 1946, there was a substantial net withdrawal by India from the Pool, mainly on account of food imports and other payments on Government account.

There was also a fund known as the Post-War Dollar Fund to which the Pool had contributed $20 million for the year 1944. In the year 1943-4, His Majesty's Government agreed, in view of our large dollar contributions to the Empire Dollar Pool and of our willingness to agree to give reciprocal aid to the United States, to place at our disposal a sum of $20 million in a separate fund to be utilized after the conclusion of hostilities with Japan for restocking and capital expenditure in the U.S.A. All expenditure for these purposes was to be met from the Fund and not till this fund was exhausted were we to ask for dollars from the Pool for the financing of such expenditure. This figure of $20 million was a percentage of our dollar earnings on trade account in the year 1944 and H.M.G. agreed that they would credit the Fund with a similar sum, up to a maximum of $20 million, for the year 1945 if our dollar earnings on the same basis for that year were of the same order as for the year 1944. In respect of 1945, H.M.G. intimated an allocation of $20 million. The limit of our purchases, however, was not necessarily the amount in the Fund, for we had the right to draw on the Pool for the import of all capital goods which we regarded as legitimate. As against the $20 million allotment to the fund for 1944 and in anticipation of further allotment, the Government of India issued sanctions for the import of capital goods, the purchase of ships and for other industrial purposes up to $28 million.

Criticism of the import control policy of Government was based on two grounds: first, that the administrative machinery for the grant of import licences was slow and inefficient and, secondly, that the strictness with which

exchange control was administered made it very difficult for importers both of capital and of other goods to import them from outside the sterling area. With the altered conditions brought about by the termination of war, the Government of India made a number of changes in the administration of import control with the hope that the procedure for obtaining import licences would be very considerably simplified and shortened. They also adopted the policy of removing as many items as possible from the list of controlled items and of placing them on the Open General Licence for the sterling area. Other items were placed on the Universal Open General Licence, which meant that these items might be imported freely from any source whether within or outside the sterling area.

The Government of India also relaxed substantially the rigidity of exchange control and the two tests of essentiality and non-availability came to be applied with more flexibility. Requirements were held to be essential if they were necessary for the maintenance and development of the national economy or the maintenance and development of the standard of living; non-availability was determined with due reference to the quality, price and period of delivery of comparable articles in the sterling area. Further, the burden of proving non-availability was shifted from the importer to Government so that Government had to satisfy itself by its own inquiries whether goods required to be imported from outside the sterling area were available within it or not; instead of, as heretofore, for the importer to prove that they were not so available. Another modification was the grading of the various currencies of the world in the order of their difficulty and the tests of essentiality and non-availability were applied to imports with a decreasing degree of strictness in accordance with the comparative easiness of the currency concerned.

§32. **Withdrawal of rupee coin and issue of one-rupee notes.**—Although, as stated above, the Indian currency system withstood the strain of the war remarkably well, and confidence in the paper currency was generally maintained, an adverse reaction set in in May and June 1940, following the worsening of the war situation in Europe. There was a heavy demand on the Reserve Bank for the encashment of notes into rupee coin. The withdrawals from the Bank, which had previously been made normally at an average of less than Re. 1 crore a week, suddenly leapt to Rs. 4 and Rs. 5 crores. After the beginning of the war, more than Rs. 43 crores of rupee coin was supplied by the Reserve Bank and hoarded till the end of July 1940, as shown by the decline in the stock of rupee coin held in the Issue Department from Rs. 75·47 crores at the start of the war to Rs. 32 crores by 5 July 1940. Under these circumstances, the Government of India decided to modify the earlier policy of permitting free withdrawals. It was physically impossible for the mints in India to produce coins at the rate at which they were disappearing into hoards, even though the silver stocks of the Government of India were ample. The Government, therefore, issued a Notification on 25 June 1940 penalizing the acquisition of rupee coin in excess of personal or business requirements. For some time, rupee coins were quoted at a premium over currency notes, and acute shortage of rupee coins and small change was experienced. These difficulties were, however, soon overcome and the Reserve Bank was able to make arrangements for the wider issue of small coin and for meeting reasonable demands for rupees. The issue of one-rupee notes through the Reserve Bank by the Government of

India, under an Ordinance issued on 24 July 1940, materially contributed to relieving the situation as such notes would not be used for hoarding even by the most short-sighted or nervous hoarder and, therefore, remained in circulation as a medium of exchange. Moreover, the issue of the new notes met a general demand for a medium of exchange smaller than the lowest Reserve Bank note (viz. Rs. 5). These notes, which are to be treated exactly as if they were a rupee coin issued under the provisions of the Indian Coinage Act (1906), are unlimited legal tender. They do not, therefore, convey any promise to pay in rupee coin, unlike the one-rupee and 2½-rupee notes issued during the war of 1914-18.

§33. **Reduction in the silver content of silver coins.**—Another measure adopted for conserving the silver resources of the country was the lowering of the standard of fineness of the silver content of certain coins. The Central Legislature authorized the Government in April 1940 to reduce the silver content of the four-anna piece from eleven-twelfths to one-half, the idea being simply to make Government stocks of the metal do more service. A similar reduction in the silver content of the eight-anna piece was effected under an Ordinance issued by the Government of India on 26 July 1940, to amend the Indian Coinage Act (1906) for this purpose. The step was taken in view of the increasing demand for quarter and half-rupee coins simultaneously with the rapid absorption of rupee coins for hoarding. The fineness of one-half silver and one-half alloy was later extended to whole rupee coins on 22 December 1940. This measure was necessitated by the increasing demand for rupee coins consequent on increased trade activities and their absorption in hoards, and the fact that the one-rupee notes already introduced were not entirely convenient or suitable for some rural areas. A new security edge device was adopted for the new rupees as a safeguard against counterfeiting. This measure relieved the scarcity of coin in circulation. In April 1947 a Bill was passed to amend the Indian Coinage Act as a result of which the nickel rupee has replaced the silver coin. A saving of 226 million ounces of silver was thus effected for the purpose of repaying the U.S.A. from whom India had borrowed the metal under the lend-lease system.

CHAPTER X

PRICES IN INDIA

§1. A bird's-eye view of price movements since 1861.—The table below indicates the general course of prices in India since 1861 with 1873 as the basic year.[1] The general index number is based on the wholesale prices of 39 articles (28 exported and 11 imported articles), except in the case of food grains, namely, jowar, bajra, barley, ragi and gram—wholesale prices of these articles not being available before 1897.

Year[2]	General index number for 39 articles (unweighted)[3]	Weighted index number (100 articles) equated to 100 for 1873	Year	General index number for 39 articles (unweighted)	Weighted index number (100 articles) equated to 100 for 1873
1861	90	93	1924	221	257
1865	107	109	1926	216	260
1870	102	107	1927	202	..
1875	94	96	1928	201	..
1880	104	109	1929	203	..
1885	87	106	1930	171	..
1890	100	117	1931	127	..
1895	104	120	1932	126	..
1900	116	143	1933	121	..
1905	110	135	1934	119	..
1910	122	150	1935	127	..
1914	147	187	1936	125	..
1918	225	215	1937	136	..
1919	276	301	1938	132	..
1920	281	302	1939	142	..
1921	236	273	1940	163	..
1923	215	259	1941 (Feb.)[4]	174	..

The Government index numbers in column two of the table are unweighted. The equal importance attached to the commodities prevents the index numbers from recording faithfully the nature and significance of the changes in the price level. India is an agricultural country and her agricultural production, which

[1] The year 1873 was chosen as the basic year because of normal seasons and because it was since that year that the depreciation of silver and the consequent depreciation of the rupee may be said to have started.

[2] See *Index Numbers of Indian Prices*, 1861-1931 and annual addenda. The weighted index numbers set out in the third and sixth columns of the above table were originally compiled by Mr F. J. Atkinson of the Indian Finance Department. The index numbers for the years subsequent to 1909 have been compiled by the Department of Statistics on the lines of his calculations.

[3] Since 1937 one in the list of imported articles has been dropped.

[4] Index numbers of wholesale prices from 1942-3 (week ending 19 August 1939 = 100) were:

1942-3	171	1947 (March)	292·7
1943-4	236·5	1948 (April)	348
1944-5	244·2	1949 (March)	370·2
1945-6	244·9	1950 (Oct.)	411·4
1946-7	275·4		

accounts for the bulk of her total production, consists of a few staple commodities like rice, wheat, cotton, jute, etc., while others are comparatively insignificant. Some articles like cotton cloth, cotton yarn, raw silk and coal have been allowed to exercise an undue influence upon the final result, and the whole series of prices is dominated by imported goods and those in direct competition with them. As the all-India index number, with 1873 as the base, is out of date, reference is usually made to the figures for the Bombay and Calcutta wholesale price indices. The base year 1873 can no longer be regarded as suitable for comparison. So also the relative importance of commodities has changed since the compilation of the series was first undertaken.

§2. **Period from 1861 to 1893.**—The general character of price movements between 1861 and 1893 was as follows:—(i) *Rising Prices* (1861-6).—The American Civil War led to a scarcity of cotton. The resulting high prices caused a great influx of specie into India and extensive coinage of silver, which was followed by a considerable rise of prices. This episode of high prices showed clearly for the first time the influence of external factors on the price level in India. (ii) *Falling Prices* (1866-83).—Except for a sudden jump in the prices of foodstuffs between 1876 and 1879 owing to a great famine, prices were falling from 1866 to 1883. This general fall in the earlier years may be regarded as a counterpart of the general downward movement of prices which began in Western countries from about 1874. It has been attributed to the slackening in the production of gold, the adoption of the gold standard by countries previously on a silver standard basis, the arrest of the expansion of the silver currency owing to the closure of the mints to its free coinage, the slowing down of the development of banking and the growing volume of trade under the stimulus of a decrease in the freight charges, and improvements in the arts of production.[1] (iii) *Rising Prices* (1883-93).—The fall in prices in India was arrested earlier than in the gold standard countries of the West, as a result of the depreciation of the rupee. It must be noted, however, that though silver began to depreciate in terms of gold roughly after 1874, the general increase in the production of commodities led to a fall of prices until about 1883. After 1885, when the production of silver definitely outstripped the production of commodities, we enter upon an era of rising prices in India. This continued right up to 1920, except for the brief interval 1893-9, when prices went down somewhat owing to the contraction of currency in India due to the closing of the mints, though the effect of this factor was a little obscured by the famines during this period. The rise in prices was the outcome mainly of the depreciation of silver and the heavy rupee coinage between 1881 and 1892.

§3. **The Prices Enquiry Committee (prices from 1890 to 1912).**—In 1910 the Government of India appointed a committee (the Datta Committee) to find out the causes of the continued rise of prices in India. The period chosen for investigation by this Committee was 1890 to 1912. During this period there was a general rise in prices throughout India which was specially marked after 1905, and particularly in the case of hides and skins, food grains (pulses and cereals), building materials, and oil-seeds, all of which rose 40 per cent or more above the level of the basic period. Cotton and jute rose about 33 and 31 per cent respec-

[1] See Irving Fisher, *Purchasing Power of Money*, p. 142.

tively, while other articles of food, metals, and other raw and manufactured articles rose by about 25 per cent. There was a moderate increase in country sugar; but, on the other hand, there was an appreciable decrease in the prices of tea and coffee, imported sugar, dyeing and tanning materials, especially indigo, coal, and shellac, as also a slight fall in the prices of other textiles. The rise in prices was greatest in India: the level during the quinquennium 1907-11, as compared with the quinquennium 1894-8, showed an increase of 40 per cent, corresponding percentage rises being 21 for the United Kingdom, 38 for the United States, and 20 for Australia.

§4. Causes of the rise of prices before the war of 1914-18.—The Prices Enquiry Committee divided the causes into two classes, namely (i) causes peculiar to India, and (ii) causes not confined to India, that is, world factors; though they recognized that the two sets of causes reacted on each other.

(i) *Causes peculiar to India.*—According to the Committee the causes peculiar to India were (*a*) shortage in supply of agricultural products, particularly of food grains, and raw materials;[1] (*b*) increase in the demand for these commodities; (*c*) development of railways and other communications in India, and the lowering of the direct and indirect costs of transport in India itself and between Indian ports and foreign countries; (*d*) improvement in the general monetary and banking facilities and increase of credit; (*e*) increase in the volume of the circulating medium.

(ii) *World factors.*—The world factors were (*a*) shortage in the supply of and increase in the demand for staple commodities in the world's markets; (*b*) the increased gold supply from the world's mines; (*c*) the development of credit; (*d*) destructive wars, and increase of standing armies and navies in most of the Western countries and the United States, diverting capital and labour into unproductive channels and causing an increased demand for many classes of commodities. India was switched on to the currency gauge of the rest of the world owing to her abandonment of the silver standard in 1893, and no doubt she shared in the price fluctuations in the rest of the world owing to these causes.

The Committee made a serious error in rejecting currency inflation as the main cause of the rise in prices. The rupee being no more than a note printed on silver and being inconvertible into gold, it was almost as easy to issue it to excess as inconvertible paper notes. That on occasions excessive rupee coinage did take place in this manner has been freely recognized even by Keynes, one of the warmest admirers of the gold exchange standard in India, as the following passage in his book, *Indian Currency and Finance*, testifies:[2] 'The effects of heavy coinage are cumulative. The Indian authorities do not seem to have understood this. They were, to all appearances, influenced by the crude inductive argument that, because there was a heavy demand in 1905-6, it was likely that there would be an equally heavy demand in 1906-7; and, when there actually was a heavy demand

[1] The shortage in the opinion of the Committee was due to (i) the growth of cultivation not keeping pace with the growth of population; (ii) unseasonable rainfall; (iii) the substitution of non-food for food crops; and (iv) the inferiority of the new lands taken up for cultivation.

[2] p. 134.

in 1906-7 that this made it yet more likely that there would be a heavy demand in 1907-8. They framed their policy, that is to say, as though a community consumed currency with the same steady appetite with which some communities consume beer.'

The view that heavy coinage was mainly responsible for the rise in prices was voiced in the Imperial Legislative Council by Gokhale in 1908 in the following words : 'The stock of rupees in existence in India before 1898 was estimated by Mr Harrison, the expert, at 130 crores. During the last ten years the Government have made a net addition to this stock of over 100 crores. Such a sudden inflation is bound to result in a general rise in prices . . . . The rupees issued by the Government in response to the demands of trade go into the interior and spread themselves among those from whom purchases are made. But they do not flow back quickly to centres of trade, or to banks, and thus new rupees have to be obtained for transactions for which the old rupees might have sufficed. Meanwhile, the melting of rupees having ceased (as a result of the token character of the rupee since the closing of the mints in 1893 and its artificial higher exchange value), every issue becomes a net addition to the volume of currency.'[1] There was a striking parallelism between the general index number of prices and the estimated total of the currency for each of the years between 1903 and 1907.

§5. Prices during the war of 1914-18 and the pre-depression period.—The tendency of prices to rise during the period before the war of 1914-18 manifested itself in an unprecedented degree during the years 1914-20, especially during the latter part of this period, owing to conditions created by the war. The rise in prices was, however, smaller in India than in some other countries, especially in those that were directly engaged in the war. The higher rise of prices abroad would normally have been corrected by a rise in exports and decline in imports. The consequent import of specie into India would have caused a rise in the internal prices until they equalled external prices. But the restrictions on the import of specie and exports of goods, as well as Government control of prices during war-time, prevented this adjustment. This was one of the reasons why India was unable to build up ampler reserves and was at a disadvantage as compared with the importers of competitive articles, when the war-time boom was followed by a depression. Again, in the absence of Government interference, exchange would have risen even earlier and more rapidly than it did and this would have stimulated imports and checked the relatively greater rise in the price of imports. India would have received better value for her exports and would have been better able to meet the cost of post-war reconstruction. The consideration, however, which prompted Government interference with exchange was that serious trade dislocation would have resulted at a very critical stage of the war if exchange had been left to itself entirely.

During the period of the war of 1914-18 the prices of nearly all commodities in India showed a steep rise. By 1919, the prices of food grains had risen on an average by 93 per cent since the beginning of the war, while the increase in piece-goods was just under 190 per cent for imported goods and just over 60 per cent for Indian-made goods. We have already observed that the prices of imported

[1]See *Speeches of Mr G. K. Gokhale*, p. 150.

goods, such as cotton piece-goods, steel and iron, sugar, dye-stuffs, etc. in general, rose much more than those of exported goods, and have also explained the causes for this disparity.[1] The shortage of production as well as the intense competitive demand of the belligerent countries for commodities of all kinds, together with the creation of a huge volume of credit and currency to finance the war, were responsible for the phenomenal increase of prices. These world conditions were bound, sooner or later, to react on India by increasing the demand for her products abroad as well as by adding to the cost of her imports. The restrictions imposed on exports by the shortage of tonnage and by Government control, however, checked the rise in prices in India to some extent.

§6. Inflation of currency.—We have already noticed that, for some time after the outbreak of the war of 1914-18, the balance of trade remained strongly in favour of India. At the same time there was a serious reduction in the imports of treasure, thus throwing upon the Government the whole of the responsibility for financing the export trade by issuing a large volume of additional currency in the form of rupees as well as currency notes. The expansion of currency of all kinds was very much greater relatively than the increase in the volume of business. The process of inflation was also helped by the methods of war finance adopted by the Government. In order to meet the heavy war expenditure they furnished themselves with the means of payment partly by raising taxation and loans and partly by printing notes. The War Loans of the Government also inevitably led to inflation. Only a portion of these loans came out of the real savings of the people. The remainder took the form of bank credits or the creation of deposits, subject to cheques, which the banks opened in favour of the Government, on their own account or on behalf of their customers who wished to invest in the War Loans.[2] The short-term Treasury Bills which were issued by the Government of India for meeting the successive budget deficits were another source of inflation as the banks lent freely against their security and that of the War Bonds. Thus there was a very large increase in the bank deposits (credits) as well as in their velocity (as shown by the bank clearings),[3] which supplied so much more buying power and thereby contributed to the rise of prices.[4] There were other causes which aggravated the rise, such as the shortage of rolling-stock during the war years and widespread failure of the monsoon in India during the year 1918-19 and again in the latter part of 1920. Prices reached their highest limit in the year 1920, with the Calcutta index number at 201 as compared to 100 in 1914. One of the causes why the rise of prices in India was not so high as in other countries was that the extent of currency inflation was far less in India, though speaking absolutely it was considerable.[5]

§7. Effects of high prices.—The Prices Enquiry Committee held that the high prices in India before the war of 1914-18 benefited the country as a whole. This view was then endorsed by the Government in their Resolution on the Report of the Committee (1914). The Committee argued that India, being a debtor

[1] See above, ch. vi, §5.

[2] Panandikar, *The Economic Consequences of the War*, pp. 317-18.

[3] See also ch. xi. [4] See Findlay Shirras, *Public Finance*, pp. 232 and 410-11.

[5] D. T. Jack, *Restoration of European Currencies*, p. 3.

country with large foreign obligations which she met by the export of part of her produce, benefited when the prices of such produce rose, because then she was able to discharge her foreign obligations by the export of a smaller volume of commodities. But as against the high prices of exports we must set the increased prices of imports and the higher cost of production. In any case it is difficult to believe that a higher range of prices, especially when it is due to an inflation of currency, is by itself capable of conferring any permanent advantages on the country as a whole, sufficient to offset its well-known disadvantages. Joshi expressed what after all is the sound view in this matter when he observed that 'a real increase of wealth and prosperity comes to nations as it does to individuals, not from any reckless piling up of coined rupees or again from any rise of prices . . . which . . . in India is almost invariably associated with crop failures and famine conditions, but only from an increase in industrial activity, energy and efficiency on the one side, and on the other, from increased productive employment of capital '.[1] Vera Anstey[2] has attempted to derive certain conclusions regarding national prosperity from price- and wage-movements in India during the periods before 1914 and after 1918. She has argued that the results yielded by this method are more reliable than those based on the uncertain estimates of *per capita* income at various dates which we have discussed in chapter iv. It should, however, be noted that an examination of price changes cannot by itself give us any information as to whether there has been any progress or setback from the point of view of *wealth production.* It merely tells us in what manner the *distribution* of wealth amongst the various classes of people has been affected by any given alteration in the price level. Moreover, its conclusions as regards benefit or injury to the nation as a whole are based on certain doubtful assumptions as to the relative importance to be attached to the welfare of the different classes. It is suggested, for example, that 'in India the bulk of the people belong to those classes which are benefited by a rise in prices ', and that the debtor classes are on the whole more deserving, so that even when they benefit at the expense of the creditor classes there is nothing to regret in this because these latter consist mainly of moneylenders who are simply 'bloodsuckers '. It seems, however, an invidious procedure to classify certain sections of society as deserving and certain others as undeserving. A really sound notion of national progress implies the prosperity of all classes and not of some classes at the expense of others. Again, difficulty arises from the fact that many people are creditors at the same time that they are debtors. It also seems rather crude to indulge in sweeping condemnation of the whole creditor class. Mrs Anstey holds that the price changes before the war of 1914-18 were of such a nature that they must at least have benefited the large body of cultivators in India; because the rise in the articles of export, that is those which the cultivator sells, for example jute (43 per cent), hides and skins (59 per cent), oil-seeds (45 per cent), food grains (42 per cent), was far more pronounced than the rise in the imports, that is articles which he purchases, for example cotton manufactures (25 per cent), metals (20 per cent), sugar (9 per cent), kerosene (no change), salt (which *fell* by 30 per cent even without allowing for the decrease in duty). A

[1] See G. V. Joshi, *Speeches and Writings*, p. 610.

[2] *The Economic Development of India*, pp. 445 *et seq.*

relative change in prices of this nature undoubtedly provides conditions under which the cultivator may benefit, but there is no guarantee that the possible advantage will be always realized in practice. The profits of the cultivator are, for instance, liable to be intercepted by a variety of other interests, and special proof is required that this has not occurred to any considerable extent before we accept the advantage to the cultivator as established beyond doubt.

During the war of 1914-18 prices of imports rose more than the prices of exports. This had the result of increasing the expenditure of the cultivator relatively to his income, and is generally admitted to have injuriously affected the agricultural classes. Here then we have a refutation of the general proposition that a rise in prices as such must benefit the bulk of the people in India.

§8. Effects on agriculturists.—It is often said that landholders and the village people in general must necessarily benefit by high prices for agricultural produce. It is, however, clear that only those who have a surplus to sell would benefit, and only in case the goods they have to purchase have not also risen in the same proportion as the goods they sell. Again, as already stated above, the gains of the agriculturists in India are intercepted to a very large extent by a numerous class of middlemen, and the high prices consequently do not result in any appreciable advance in the economic condition of the agriculturist. We must also take into account the fact that, while cultivators of their own land and of lands rented on long leases, depending on their own labour and having a surplus to sell, stand to gain by high prices, this does not hold good of those who have to make rent payments in kind or who have received advances repayable in grain, or again those who hold short-term leases of land or have to employ hired labour. Moreover, both classes of cultivators have to reckon with increased expenses of production and higher prices of commodities like cloth, oil and other prime and conventional necessaries of life.

Wages lag behind price changes, so that when prices rise there is a shorter or longer period of hardship which wage-earners must generally go through. In this connexion it is necessary to bear in mind that many petty cultivators in India are also wage-earners. According to Mr Datta, however, the wages of rural labour—agricultural labourers and village artisans—rose faster before the war of 1914-18 than the retail prices, and the rise was the greatest in rural areas, where the real wages of these classes showed an increase of 38 per cent. Similarly, during the war and post-war period there was apparently a progressive adjustment of rural wages to prices, established after an interval of considerable suffering during the period of non-adjustment. The fall in prices after 1921 further secured some increase of real wages to the rural labourer.

A downward tendency, however, became noticeable in wages after 1926, especially in the rural areas. This tendency was accelerated during the years of the economic depression (1929-33). There was in these years a sharp fall in rural wages, although this was to some extent offset by the cheapness of foodstuffs and other necessaries of life (see §12 below).

Regarding the effects of a rise in prices on cash rents, a distinction is necessary between protected or privileged, and unprotected classes of tenants. In the former case, illustrated by the class of occupancy tenants, rents would naturally show a

comparatively small rise; while in the second case the increases might be very considerable.[1]

§9. **Effects on industry.**—(i) *Handicrafts.*—We have already drawn attention to the condition of economic stagnation of persons engaged in indigenous handicrafts owing to the competition of machine-made goods. The rise in prices, if anything, increased the severity of this competition and made the position of the handicraftsmen even weaker than before. (ii) *Capitalist manufactures.*—The rise in prices during and after the war of 1914-18 no doubt brought the manufacturers immense profits. But these profits were mostly dissipated in the distribution of recklessly high dividends, instead of being utilized for strengthening the reserves. 'Full steam ahead and damn the consequences' seemed to be the motto of the mill-owners, and they had later to pay the penalty for this policy.

§10. **Labour in rural areas and cities.**—In the period before 1914, the nominal and real wages of the different classes of labourers rose, though the rise in real wages was not so high as in the rural areas, being 38 per cent in the rural areas and 28 per cent in the cities. The rapid rise of prices between 1917 and 1920 led to an epidemic of strikes, and in some cases there were even bread riots and looting of bazaars. After 1921, however, a definite improvement in the condition of industrial labour, both by an increase of wages and a progressive fall in the cost of living, took place. But the adverse position of industry in the years of depression resulted in lower wages, widespread unemployment and much suffering among the wage-earning classes. A partial improvement was effected in 1938 in consequence of restoration of wage cuts in Bombay and some other provinces (see ch. iii).

§11. **Effects on persons with fixed incomes.**—The worst sufferers from high prices are persons with fixed money incomes, like pensioners, clerks and, in general, the lower grades of state and commercial employees, or those dependent on income from securities and shares, and professional men who live upon customary fees. These classes, collectively styled the middle classes, suffer greatly during periods of high prices owing to their fixed money earnings and the heavy increase in the cost of food, clothing, lighting, house rents, and the wages of such labour as they happen to employ. Their social status debars them from undertaking work of certain kinds, while the market in which they themselves compete for employment is chronically overstocked. Nor have they yet learnt the value of organization and collective bargaining.

§12. **Prices during the depression and post-depression periods.**—Prices in India having reached their maximum in 1920 began to decline from 1921, and for some time the process was more rapid in the United Kingdom than in India, endangering the Government policy of stabilizing the rupee at 2*s.* gold. The sale of the Reverse Councils in 1920 and the consequent deflation of currency led to a fall of prices. Also, as a result of the adverse balance of trade in 1920-1 and 1921-2, there was an actual export of gold from India. Lastly, there was the influence of world forces on Indian prices, explaining the striking parallel down-

[1] It may be noticed that in recent years there has been an attempt on the part of the labouring and tenant classes to secure for themselves the advantages of collective bargaining by the formation of tenant unions and *kisan sabhas*, not to speak of recent legislative interference on their behalf.

ward movement in India, the United States and the United Kingdom until 1929. The influence of the 1*s.* 6*d.* ratio in depressing Indian prices has already been dealt with.

The downward movement of prices was appreciably accelerated during the period of the world economic depression which was ushered in by the Wall Street collapse in America (October 1929).[1] It was a phenomenon from which no part of the civilized world escaped, as may be seen from the table below.

Index numbers of wholesale prices in Calcutta and Bombay and some foreign countries

	India (Calcutta)		India (Bombay)[2]		United Kingdom (Board of Trade)	United States of America	Canada	Australia (Melbourne)	Japan	France
	July 1914 = 100	1929 = 100	July 1914 = 100	1929 = 100	1929 = 100					
1929 average	141	100·0	145	100·0	100·0	100·0	100·0	100·0	100 0	100·0
1930 "	116	82·3	126	86·9	87·5	90·7	90·6	88·5	82·4	88·4
1931 "	96	68·1	100	75·2	76·8	76·6	75·4	79·2	69·6	80·0
1932 "	91	64·5	100	75·2	74·9	68·0	69·8	78·3	73·3	68·2
1933 "	87	61·7	98	67·6	75·0	69·3	70·2	78·2	81·6	63·6
1934 "	89	63·1	95	65·5	77·1	78·7	74·9	81·6	80·8	60·0
1935 "	91	64·5	99	68·3	77·8	83·9	75·4	81·5	84·4	54·0
1936 "	91	64·5	96	66·2	82·7	84·8	78·0	85·6	89·9	65·5
1937 "	102	72·3	106	73·1	95·2	90·6	88·4	91·9	108·4	92·7
1937 August	105	74·5	106	73·1	97·5	91·8	89·5	95·4	107·0	96·2
1938 average	95	67·6	101	69·7	88·8	82·5	82·2	92·2	114·3	104·1
1939 Jan.	96	68	100	69	85	81	77	94	118	110
1939 August	100	71	103	71	86	79	76	89	124	107

The prices of primary products fell more than those of manufactured articles, and agricultural countries like India were more adversely affected thereby than industrial countries like the United Kingdom. The Calcutta wholesale price index number (July 1914=100) stood at 143 in September 1929. In September 1931, when Great Britain went off the gold standard, the index number stood at 91 (i.e. below the pre-war level). The rupee, which was then linked to sterling, reacted to the immediate consequences of sterling's departure from gold, and the price level improved to 98 in December of the year. This advantage was not maintained in 1932, which saw a steady decline to lower levels, the index number falling to 88 in December 1932 and 82 in March. But thereafter the price level steadied itself. India in common with the rest of the world shared in the gradual economic recovery. There was a partial though slow recovery of prices from April 1933 to August 1937. Prices had moved up by as much as 11 points by August 1937, when the Calcutta index attained its maximum at 105. This rise was caused partially by the worldwide rearmament campaign and prevalence of boom conditions and speculation. The process of partial recovery of prices received a setback

[1] See ch. vi, §7.

[2] *Review of the Trade of India* (1939-40), p. 75.

with the recession in business conditions in the United States of America and other countries of the world about the middle of 1937. This had a depressing influence on prices in India. The Calcutta index steadily declined from August 1937 in sympathy with the general fall of prices in the world markets, and reached its lowest point of 94 in April 1938. It remained unchanged till June 1938. From July 1938 to January 1939 the index stood at 95. Thereafter a firmer tendency was noticeable and the index number rose by slow degrees to 101 in May 1939. The rise was mainly due to the firmness of sugar, tea, raw jute and jute manufactures. The index number fell to 100 in July, when almost all the markets in India were adversely affected by the uncertain political situation in Europe and the shadow of war. There was no change in August, though the portents of an early outbreak of war had begun to appear in that month. Thus the Calcutta index stood just at the same level (100) as in the last pre-war year 1914.

It will be noticed from the table on page 304 that the price fall was greater in India than in other countries. For example the percentage decline in prices from the peak in 1929 to the lowest level reached during the depression was 44·3 in India as compared with 30·4 in the United Kingdom, 38 in the United States of America, 28·5 in Australia and 35·8 in Japan. In the U.S.A., after the disastrous fall of prices up to March 1933, a welcome improvement was noticeable before the recession. In April 1935 there was a gain of about 8 points in the wholesale price level in that country due to the devaluation of the dollar as well as to the operation of the N.R.A. (National Recovery Administration) and the Agricultural Adjustment Administration. In Japan, which left the gold standard in 1931, the trend was definitely upward, especially from 1935. In France, which was the most important country in the gold bloc, the trend of prices was almost continuously downward, until the devaluation of the franc and virtual abandonment of the gold standard towards the end of September 1936. After that, prices in France advanced considerably. Prices in India did not advance to the same extent as in other countries during the period of partial recovery. The highest point attained by the index number was about 75 (1929 = 100) in August 1937 as compared with 97·5 in the United Kingdom and 91·8 in the United States in the same month.

One serious aspect of the price fall in India was the disparity in the price levels of raw materials and manufactured articles. This is shown by the index numbers of prices of exported articles, comprising mostly raw materials,[1] and for imported articles, consisting mostly of manufactured articles. As compared with September 1929, there was in March 1933 a fall of 51 per cent (according to the Calcutta index) in the case of exported articles, while in the case of imported articles the fall was only 27 per cent. This discrepancy meant unfavourable terms of barter trade for agricultural countries like India in their trade with industrial countries. During the period of partial recovery of prices, especially after the middle of 1936 (when the prices of primary commodities recorded a considerable appreciation), there was a marked tendency for the prices of manufactured (imported) goods to adjust themselves more and more to the level of exported articles, as shown by the

[1] The prices of agricultural staples like rice, wheat, jute, oil-seeds and cotton fell disastrously, especially in the years 1930-3.

fact that the level of export prices was 29 per cent down in March 1937, as compared with 25 per cent in the case of import prices (with 1929 as the base). Thus the difference between the two was reduced to four points. This had a beneficial effect on the economy of India, which is predominantly an agricultural and raw-material-producing country. The process of rectification of agricultural and industrial price movements was once again disturbed during the recession period. This confirms the thesis that the prices of primary commodities are more sensitive to cyclical fluctuations than prices of finished goods.

§13. **Causes and effects of the fall of prices.**—The causes of the worldwide fall in commodity prices during the period of the Great Depression were monetary as well as non-monetary. The total world-production of gold until recently did not keep pace with the demand, and the position was aggravated by maldistribution of the available supply, most of which was absorbed by the United States and France. This resulted in depleting the reserves of the central banks in other countries, forcing them to follow a policy of drastic deflation. The principal non-monetary cause was overproduction in comparison with the normal rate of consumption of raw materials as well as manufactured articles, but especially of raw materials. The political unrest in many countries, notably in India, China and South America, further aggravated the depression and fall in prices. We have already referred to the view that the overvaluation of the rupee at 1*s*. 6*d*. depressed prices in India. This factor, to the extent to which it operated, applied to the earlier period of non-adjustment rather than to the later period. It is obvious that world factors were far more to blame than internal causes. The economic recession which began in the United States of America in April 1937 and which was responsible for the reversal of the price trends in India in common with the rest of the world was caused by the inevitable collapse of speculation combined with other factors such as the gold scare in the United States of America, the warning uttered by President Roosevelt that prices were rising too high and too fast, the restrictions placed on credit facilities by banks and the relaxation of restriction schemes under boom conditions.[1] The downward trend in India was accentuated by the prolonged Sino-Japanese hostilities which seriously curtailed the trading capacity of India's principal customer for cotton. The adverse effects of the fall in prices on the foreign trade of India and the balance of trade, as also on the inland trade, during the depression and recession periods have already been discussed (see ch. vi, §§9 and 23). The agriculturist was hard hit because his receipts dwindled owing to collapse of prices while his obligations in the shape of land revenue, rent, interest charges, etc., even when nominally unaltered, became actually more and more onerous. This seriously aggravated economic depression in the country by reducing the purchasing power of the agriculturist. It should be noted, however, that in spite of the fall in agricultural prices, our agricultural production did not contract as prices fell; in some cases even a tendency to increase in production was evident. In the Indian conditions, the agriculturist has to receive what price he can, and a vicious circle is set up whereby a decline in prices brings about some overproduction, and overproduction further depresses prices. The production of industrial raw materials like jute and rubber showed some decrease. The economic

[1] H. V. Hodson, *Slump and Recovery* (1929-37), pp. 440-2.

blizzard also seriously affected public finance, through increased taxation, drastic retrenchment, deflation of currency, exports of gold and deficit budgets.

The big drop in the purchasing power of the agriculturist and the heavy burden of taxation adversely affected the position of industry and the volume of employment (see also chs. xii and xiii) though the depression was not so acutely felt there as in agriculture.[1] All this shows that Indian economy is particularly sensitive to a fall of prices owing to the predominantly agricultural character of the country and the disparity between the cyclical movements of agricultural and industrial prices. During the period of partial recovery (March 1933 to August 1937), there was a limited improvement in the economic situation in India. India like the rest of the world experienced a certain lowering of prices of goods and securities and of industrial profits. But the recession itself appeared to be receding even before the outbreak of World War II which initiated a period of rapid rise in prices.

§14. **Prices from September 1939 onwards.**[2]—In September 1939, following the outbreak of war, industrial production and commodity prices took an upward trend owing to the belief that the war meant brighter prospects for Indian industry and agriculture.

Japan's entry into the war and the intensification of hostilities in Africa rapidly transformed India into a vital supply base for the strategy of the United Nations in the East and Middle East. The volume of war contracts placed by the Supply Department continued to mount, and the increasing payments received from His Majesty's Government on account of supplies of war materials and services to them and allied nations led to a growing accumulation of sterling balances and large issues of currency for immediate payments in India. The country's own defence expenditure also underwent a considerable expansion and the amount of borrowings rose correspondingly. Note circulation and scheduled banks' demand liabilities showed a steady rise during the year, while the amount of cheques passed through the clearing houses in India supervised by the Reserve Bank increased. The table on p. 308 shows the rapid rise of Indian prices between 1939 and 1944 and affords a comparison with the price trends in some foreign countries. Wholesale prices (Economic Adviser's Index) went up by 50 per cent during the eleven months up to May 1943, the Calcutta index number showing a greater rise of 79 per cent during the same period. The cost of living followed the trend in wholesale prices, the rise in the Bombay index number during the year being 52 per cent. The extension of the war to the Pacific and the scarcity of shipping space led to a severe contraction of foreign trade, while difficulties of transport for civilian goods, speculation and profiteering accentuated the maldistribution and shortages of foodstuffs, cloth and other essential articles and the growing scarcity of consumers' and producers' goods available for civilian use due to diver-

[1] Although industrial prices, profits and share values declined, it is noteworthy that industrial production was on the up-grade owing to the operation of certain favourable factors, such as the swadeshi movement, the levy of protective tariffs (e.g. on iron and steel, textiles, sugar, etc.), the Indo-Japanese Trade Agreement, low money rates, and cheap imports of machinery and stores.

[2] See *Reports on Currency and Finance* from 1939-40 to 1946-7.

sion of resources to war service. Disbursements in connexion with the war-effort, on the other hand, led to a rapid increase in the purchasing power in the hands of the public, not all of which could be drawn off by taxation and borrowing.

Immediately after the outbreak of war, commodity prices in India took an upward trend owing to the belief that the intensification of economic warfare meant brighter prospects for Indian industries and agriculture. The acceleration of the export movement following the increased demand for Indian produce; the

Index numbers of Wholesale prices in India and some of the principal countries of the world[1]

	India		U.K.	U.S.A.	Canada	Germany	Japan	Sweden	Switzerland
	Calcutta	Bombay							
Average	July 1914 = 100	July 1914 = 100	1930 = 100	1926 = 100	1926 = 100	1913 = 100	Oct. 1900 = 100	1935 = 100	July 1914 = 100
1939 ..	108	109	103	77	75	107	278	115	111
1940 ..	120	118	137	79	83	110	311	146	143
1941 ..	139	137	153	87	90	..	..	..	..
1942 Mar.	153	197	159	98	95	..	..	184	170
1943 ..	307	..	..	..	..	..	..	..	..
1944 ..	297(x)	..	167(ix)	135(ix)	137(ix)	109(viii)	142(vi)	..	179(vii)

decline in imports owing to greatly increased insurance costs and difficulty of obtaining freight; domestic buying for profiteering and/or for providing for future shortage; holding back of supplies for high prices; speculative operations in the markets; and the general optimism as regards the future trend of commodity values as well as the volume of off-take, were the principal factors which account for the jump in prices during the first four months (September 1939 to December 1939) of the war period.

The sudden reversal of the upward trend of prices from January 1940 to June 1940 was partly a reaction to the rise in prices due to speculation during the first four months of the war. The prompt institution of price control, fears of increased Government control of prices, the announcement of the Excess Profits Tax, and the virtual loss of the Continental markets to India also tended to bring about a decline in prices. Other contributory factors were restrictions on exports, exchange control and the withdrawal of more than Rs. 40 crores of value from the credit structure of the country which was locked up in useless metal.[2]

Since 1942, the trend of prices has been upward (see p. 296, footnote 4). The inflationary trend set up by World War II has been of much longer duration than that generated by World War I. Only three years after the end of World War I, i.e. in 1921, a marked downward trend of world prices had started. But even in the fifth year after the termination of World War II, the inflationary process

[1] *Review of Trade of India* (1941-2), pp. 76-7. Figures for 1944 taken from the *Eastern Economist*, 7 April 1944. Roman numerals indicate months.

[2] See *Reserve Bank of India, Report of the Ninth Annual General Meeting of Shareholders* and *Annual Report of the Reserve Bank of India*, 1940.

still continues. This is because World War II caused a much more serious destruction of wealth and impairment of productive capacity than World War I. It was also far more expensive and involved the creation of a much larger volume of purchasing power, much of which went into the hands of people more under the necessity of spending than able to save. Lastly, while the end of the first World War was followed by a comparatively long interval of peaceful activity, feverish rearmament and an ever-increasing demand for basic and strategic materials have characterized the post-war years after 1945. India, having at present far more points of contact with the outside world than she had twenty-five years ago, has been more powerfully affected by all these world factors. The unprecedented increase in the volume of our currency since 1939, the partition, and lastly the recent devaluation of the rupee are the other factors to be considered in accounting for the rise in our price levels. The only sure means of arresting this process is to increase production.

§15. **Effects of price changes during and after World War II.**—Following the sharp rise in prices initiated by the war, high hopes were entertained regarding improvement in the prospects of the Indian agriculturist. It was thought that the cultivator would be able to wipe off his debts and make better profits after a prolonged period of depression. It was hoped that the Co-operative Movement, which had been suffering from the incubus of heavy overdues, would be relieved of that burden and would thus receive a welcome stimulus. Actually the cultivator did not derive a substantial benefit, even when prices were high during the first four months of the war as he had already parted with his produce. After the newly harvested crop came into the market it was only for a few weeks that commodity prices were sufficiently high to confer any tangible benefit on those cultivators who were wise enough not to wait for still higher prices. The subsequent slump in prices adversely affected the purchasing power of the agriculturists and led to a deterioration of the economic conditions in the rural areas.

The tremendous rise in prices which has taken place since 1940 has had far-reaching effects on the distribution of wealth in India. Those engaged in trade and industry have generally speaking prospered beyond expectation. Some of the benefit has also filtered down to the producers of primary commodities and the burden of agricultural indebtedness and government dues has automatically become lighter. But the position of those with fixed incomes has deteriorated to the point of distress, most vividly and painfully exemplified in the death by starvation of about a million people in Bengal. This distress has been successfully avoided in the United Kingdom and U.S.A. as a result of effective rationing, price-control and anti-inflationary measures.

CHAPTER XI

BANKING AND CREDIT[1]

HISTORY OF INDIAN BANKING

§1. **Indigenous banking.**—Indian banking is as ancient as Indian commerce. Perhaps India knew more about banking and knew it earlier than any other country in the world. The *Arthashastra* of Chanakya (about 300 B.C.) describes powerful guilds of merchant bankers who received deposits, advanced loans, and carried on functions in many ways comparable to those of modern banks. Meadows Taylor in his *Student's Manual of the History of India* gives a flattering description of ancient Indian banking in the following words: 'The laws of Menoo disclose how thoroughly the science of banking was known 3,000 years ago. Then bankers understood and followed the fluctuations of money value: they kept account books, day-books and ledgers by single and double entry. They charged interest, simple and compound, they made insurances by sea and land, they granted bills of exchange, and in short they followed the practices of modern times which are little changed from ancient rules.'

The Muslim invasions of India initiated a period of disturbance and insecurity fatal to these old banking institutions. It was no longer safe for people to entrust to them their savings, which began consequently to be secreted in hoards. Individual bankers, however, continued to prosper and they usually combined commerce with banking. They advanced loans to the state, and many influential bankers' families were attached to one or other of the native courts. 'No royal court was complete without a state banker, who was often invested with the powers of a minister.' The history of the house of Jagat Seth, hereditary bankers of the Nabobs of Bengal, shows the important part played by these bankers in the politics of the country.[2] Even the East India Company had to rely on Indian bankers for loans and remittances, and they continued to wield a dominant influence as state financiers till the advent of the European Agency Houses. Besides the competition of these Agency Houses, towards the end of the eighteenth century several circumstances arose which were adverse to the continued prosperity of the indigenous bankers, for instance the establishment of European types of banks, such as the Presidency Banks, and the introduction of a uniform currency which hit the important money-changing part of their business. These bankers, however, managed to survive.

[1] The most authoritative and exhaustive treatment of the subject of Indian banking and credit is available in the Report and volumes of evidence of the various Provincial Banking Enquiry Committees and of the Central Banking Enquiry Committee, appointed in 1929-30. Before submitting its own Report, the Central Banking Enquiry Committee had to take into consideration the Reports of the Provincial Committees. It had also to consider the views of a specially requisitioned body of six foreign experts. The foreign experts wrote a separate Report which has been included in the Central Committee's Report. The Central Committee's Report (1931) is often referred to in this chapter as *C.B.R.*, the numbers indicating the paragraphs.

[2] See H. Sinha, *Early European Banking in India*, pp. 1-3.

Even now the indigenous banking system constitutes an important part of the monetary organization of the country. The Indian banker[1] is to be found in every village, town and city in the country. 'The type ranges from the small village capitalist to the wealthy well-established private partnership, generally a family partnership, of merchant bankers which has agencies in and outside India. A special type is that of the Chetty community in Madras, where there exists something approaching to joint responsibility of the community as a whole.'[2] The Nattukottai Chetties of the Madura District of Madras are especially famous as traders and bankers, and their operations are almost worldwide in scope. The banking business carried on by Indian shroffs and money-lenders must be enormous in the aggregate. The general standard of business morality among Indian bankers has been universally recognized to be very high. Indigenous Indian banking is not organized on the joint-stock basis. Generally also there is comparatively little capital from deposits, and withdrawals against deposits are in cash and not by cheques. There is no share capital, and the liability is single or, in the case of a partnership, joint, and it is unlimited. The Indian banking firm or shroff generally combines trade with the business of finance. Indian shroffs, unlike the English bankers of the eighteenth century, have never issued notes payable on demand, although legal prohibition to issue notes did not exist for a long time. The great difference between modern banking on European lines and the indigenous banking system arises from the growth of joint-stock banks in modern times and the universal use of the cheque as a means of remittance through the mechanism of clearing houses. In times gone by, the principal business of the shroffs was to change money, a function which was especially important when each petty state minted its own standard coin and the country was flooded with a large quantity of varied forms of metallic money. The shroffs also gave letters of credit, dealt in *hundis*, which are the indigenous analogue of cheques or internal bills of exchange, and occasionally helped the state in financing great undertakings.

§2. **Present position of indigenous banking.**—To this day the shroff continues to play an important part in the financial system of the country as an indispensable link between the Indian money market and the vast trading community. He finances the agriculturist, the petty artisan and the smaller trader, assists in the movement of crops to consuming areas or to the ports, and distributes all kinds of goods in the interior of the country. He sends his agents with specie by rail, when necessary, in the harvest season, or he buys bills on Government Treasuries, and, when in need of funds, discounts his bills with the Imperial Bank or other banks in the commercial towns.[3] The indigenous bankers are in some ways formidable competitors to the big joint-stock banks organized on modern lines. As they pay a higher rate of interest they sometimes attract deposits more readily than the

[1] The Central Banking Enquiry Committee gave the following definition: 'By indigenous bankers is meant all bankers other than the Imperial Bank of India, Exchange Banks, the Joint-stock Banks and Co-operative Societies, and the expression includes any individual or private firm receiving deposits and dealing in *hundis* or lending money.'—Par. 107. Those who do not receive deposits fall under 'other indigenous credit agencies' (e.g. the village money-lender).

[2] M. S. M. Gubbay, *Indigenous Banking in India*, pp. 11-12.

[3] See Shirras, *Indian Finance and Banking*, p. 241.

bigger banks. They also lend on personal security, and, in general, their requirements with regard to security are more easy to satisfy than in the case of banks. They are also at an advantage because under the present conditions the modern type of banks in India can never hope to get into sufficiently close touch with the affairs of the vast trading community all over the country to enable them to grant accommodation directly to more than a few of the bigger traders. The Indian bankers, therefore, are in existing circumstances indispensable middlemen. The Babington Smith Committee describes in the following words the manner in which the indigenous financial agency comes into contact with the modern monetary organization: 'The people with whom the banks deal directly are for the most part large shroffs of good standing in the principal cities. These men operate with their own capital and, generally speaking, it is only when they have laid out all their available capital in purchasing the *hundis*[1] of other and usually smaller shroffs that they come to the Presidency Banks. The shroffs, whose *hundis* the larger shroffs have purchased, have probably also similarly financed other and still smaller shroffs or *mahajans*, and so on, until we get down to the smallest flea of all, namely the village *bania* or grain-dealer or goldsmith.'

The growth of modern banking has not materially affected the business of the shroff. On the other hand, he has good reason to welcome it as relieving him of much inconvenience, for example, as regards sending specie and obtaining accommodation. He buys the *hundis* drawn by the trading community, charging them a rate of discount above the bank rate, the difference constituting his profit.[2] Though some of the indigenous private banking firms are being converted into private banks conducted on modern lines and issuing cheques, most of them still follow their traditional methods.

§3. Need for co-ordination between the old and new banking systems.—It is generally recognized that in order to mobilize effectively the capital resources of the country as well as to establish any kind of unitary control over its credit organizations the indigenous banking system must be brought into an organic relationship with the new joint-stock system. As Sir George Schuster pointed out in the course of his remarks on the Reserve Bank Bill (1933) in the Assembly : ' It is impossible to over-estimate the importance of the part that the indigenous banker plays in the whole of the banking and credit machinery of India. I think it will be no exaggeration to say that his part of the organization represents, if anything, more than 90 per cent of the whole ; and it is unfortunately true that the links between the whole of this system and the modern banking system of India, in spite of the development of rural co-operative societies and in spite of the opening of one hundred new branches by the Imperial Bank of India,

[1] *Hundis* are drawn to serve three distinct purposes: (i) for raising a loan (here the *hundi* corresponds to the finance bill or hand bill); (ii) for financing trade, when it corresponds to a bill of exchange (but *hundis*, unlike bills of exchange, are not always accompanied by documents of title like sale contracts, invoices, and warehouse receipts, and are usually without them); (iii) for remittance of money from one place to another, whether for purposes of trade or otherwise.

[2] The bazaar *hundi* rate of discount is as a rule 2 or 3 per cent above the bank rate in Calcutta, and about 1½ per cent in Bombay, where the competition amongst the shroffs is unusually keen.

are still rudimentary and incomplete . . . . . Until the vast portion of India's banking and credit machinery, which is represented by the indigenous bankers, is put into gear with the relatively small machine of the modernized money market, with the Reserve Bank as its central control, it will be impossible for the Reserve Bank to exercise full control of the currency and credit of India, which is understood as the function of a Central Bank in Western countries ; and it will be equally impossible for the masses of the people who populate the countryside of India to get the full benefits of credit and banking facilities on reasonable terms, which a well-organized system of banking ought to give.'

The Central Banking Enquiry Committee made a series of recommendations in this connexion. They favoured linking the indigenous bankers directly with the Reserve Bank. They suggested certain conditions for the inclusion of indigenous bankers in the Bank's approved list, such as the limitation of their business to banking proper, having a certain suitable standard of owned capital (which should be lower than in the case of joint-stock banks), maintaining of account books in the usual manner and having them audited annually by recognized auditors, and making them available to the Reserve Bank for inspection and audit. Indigenous bankers scheduled to the Reserve Bank were to be given certain privileges, the principal ones being the rediscounting of their commercial paper by the Reserve Bank, remittance of funds at the same rates as are charged to all joint-stock banks and extension of the benefits of the Bankers' Books Evidence Act.[1] (*C.B.R.*, 139-42.)

§4. Reserve Bank's scheme of linking indigenous bankers.—A statutory obligation was imposed on the Reserve Bank under clause 55 (1) (*a*) of the Reserve Bank of India Act (1934) to present a ' report at the earliest practicable date and in any case within three years to the Governor-General-in-Council with proposals, if it thinks fit, for legislation on the extension of the provisions of this Act relating to scheduled banks[2] to persons and firms not being scheduled banks engaged in British India in the business of banking '.

The then Governor of the Reserve Bank issued a draft scheme in 1937, for the direct linking of private bankers in accordance with the recommendations of the Central Banking Enquiry Committee and the regulations relating to banking companies incorporated in the Indian Companies Act as amended in 1936.[3] The Bank suggested that if the indigenous bankers were to come into practical relationship with itself, they would have to formalize their methods of banking on lines approximating to joint-stock banks and in particular develop the deposit side of banking activities. Indigenous bankers with owned capital of at least

[1] The Central Banking Enquiry Committee made certain other recommendations regarding the indigenous bankers, for instance, that the Reserve Bank and the joint-stock banks should use such bankers as their agents for the collection of cheques and bills in the same manner as in the case of banks, that indigenous bankers on the approved list of the Reserve Bank should be allowed to affix against their names the designation 'Member of the Central Bankers' Association' when the latter was established, etc. They did not, however, favour compulsory licensing of indigenous bankers, being apprehensive that compulsory licensing would scare them away and discourage them from following banking pursuits. *C.B.R.*, 138 and 145.

[2] See §43 below

[3] See §19.

Rs. 2 lakhs—which might be raised to Rs. 5 lakhs at the end of five years—would be entitled to apply for registration in the books of the Reserve Bank as private bankers. They must wind up their non-banking business within a reasonable time. They would not have to furnish compulsory deposits unless their time and demand liabilities were five times and more in excess of their capital in the business. They must maintain proper books of accounts and have them audited by registered accountants. They must file with the Reserve Bank periodical statements of their affairs and must also in the interest of their depositors publish the returns prescribed for banking companies. Indigenous bankers satisfying these conditions would have the privilege of direct rediscount with the Reserve Bank against eligible paper, the right to secure advances against Government Paper, and remittance facilities similar to those for the scheduled banks. The replies to this scheme received from the shroffs and commercial bodies showed that generally the indigenous bankers disagreed with the suggestions regarding taking of deposits and giving wide publicity to accounts. They were also not prepared to confine themselves to banking business. They thus desired the Reserve Bank's scheme to be so modified as to be incompatible with its main proposals. The Reserve Bank therefore informed the Government of India that it could not recommend any immediate legislation to amend the Reserve Bank Act in regard to the extension of its provisions relating to scheduled banks to the private bankers.

§5. **Beginnings of modern banking.**—The European system of banking was first introduced into India by the Agency Houses of Calcutta, which started a banking side as an aid to the conduct of their business. In their capacity as bankers, the Agency Houses did business with the merchant princes in India and with the planters, advancing loans on mortgages of ships, indigo factories, etc. The European community in India and the English officers of the East India Company deposited their savings with them in preference to investment in public securities owing to the attractive rates of interest offered by the Agency Houses. The Agency Houses came to grief as a result of speculative transactions, and the commercial crisis of 1829-32 put an end to them. The banks managed on European lines were thus not at first joint-stock banks, nor are they so exclusively at the present day. European firms like Grindlays have a banking side to their business. The first purely banking institution on European lines was the Bank of Hindostan, established in Calcutta by Messrs Alexander & Co. The bank disappeared in the crisis of 1829-32 when the firm of Messrs Alexander failed along with some others. On their ruins arose the Union Bank, a joint-stock bank created by co-operation among all the leading Calcutta houses, but this also disappeared in 1848.[1]

§6. **The Presidency Banks.** The foreign trade of the country was comparatively small in the earlier part of the nineteenth century, and the financing of the internal trade was looked after by the indigenous bankers already described. As trade gradually developed, the need for banks of the European type was experienced, added to which was the interest of the Company's Government in regard to their own banking business. In these circumstances the Bank of Bengal, the oldest and the most powerful of the Presidency Banks, was established at Calcutta in

[1] The subsequent progress of joint-stock banks in India is reviewed in §§13 and 17.

1806 by a charter issued by the East India Company with a capital of Rs. 50 lakhs, 10 lakhs being contributed by the East India Company. The first Bank of Bombay was established in 1840 with a capital of Rs. 52 lakhs, three lakhs of which was subscribed by the Government. This bank came to grief in 1868 as a result of its participation in the wild share speculation caused by the civil war and cotton famine in America. A second Bank of Bombay was established in the same year with Rs. 1 crore as capital. The Bank of Madras was started in 1843 with a capital of Rs. 30 lakhs, three lakhs being subscribed by the East India Company. The establishment of the three banks put an end to the possibility of the Bank of Bengal becoming a bank for all India, an idea which had been in the air for some time. From the very beginning, the Presidency Banks had a close connexion with the Government of the country, which not only subscribed a part of their capital, but also had the right to nominate some of their Directors. Up to 1857 the offices of Secretary and Treasurer were usually held by a Civil Servant of the East India Company. In return, the banks enjoyed some concessions, of which the monopoly of Government banking was the most important. The right of note issue had little practical value on account of several restrictions, such as that the total liabilities on demand were not to exceed three times the cash reserves at first and four times afterwards. From 1839 onwards even the total amount up to which the notes could be issued was fixed. In 1862, as we have already seen, the right of note issue was taken away, the Government having introduced their own paper currency. As a sort of compensation, the cash balances of the Government were placed with the Presidency Banks at the Presidency towns.

By the Presidency Banks Act of 1876, the Government withdrew their portion of the capital and relinquished the right of appointing Directors and Secretary and Treasurer. After this the Presidency Banks lost their official character but remained distinct from other banks, being governed by the special Act of 1876 and regarded by both the public and the Government as the most important constituents of the banking system of the country and as an integral part of the Indian treasury system. The bulk of their business was like that of any ordinary bank, namely receipt of deposits and discounting. But they acted as bankers to the Government to a limited extent. For instance, they managed the temporary public debt of the Government of India and enjoyed the privilege of using certain minimum Government balances. Although not state banks, they always had some connexion with the state, and under the special Act of 1876, the Government were entitled to audit their accounts, to call for information and to make it obligatory on them to publish weekly statements of their accounts. This public control was intended to safeguard Government interests and ensure development of banking on sound lines in the country.

§7. The Reserve Treasury system.—Between 1863 and 1876 the whole of the Government balances at headquarters was kept with the Presidency Banks. But trouble having been experienced in getting the funds back from the Banks of Bengal and Bombay, the Government of India established their own treasuries (Reserve Treasuries) in 1876 at Bombay, Calcutta and Madras. The Government balances henceforward were held largely in these three Reserve Treasuries, only small amounts—just enough for safety and day-to-day requirements—being held

in the district and taluka treasuries. Under the new arrangements which came into operation in 1876, the Government agreed to pay interest to the banks on the difference between the actual deposits and the minima fixed, in case the former fell short of the latter, but they gave no undertaking to keep any balances whatsoever with the banks. Actually the banks held cash balances generally in excess of the minima, though they were far from satisfied with this. A large amount of revenue flowed into Government Treasuries and remained locked up there, especially at a time when it was badly wanted by the money market. Broadly speaking, November to June is the busy season in India, and July to October is the slack season (except in Calcutta where the busy season falls between July and October). The receipts of revenue are heaviest during the four months from January to April, so that the heavy revenue period synchronizes with the active business season. The Government had to maintain large working balances, as the receipts of revenue are very unevenly distributed throughout the year, whereas their expenditure proceeds at an even pace. It was, however, generally felt that it was possible for the Government to extend greater assistance to the money market without endangering their own safety.

During the war of 1914-18 the Government placed large funds—much in excess of the minima—at the disposal of the Presidency Banks in order to facilitate the investment by the public in the War Loans. The Reserve Treasury system was abolished in 1921, and the Government balances over and above those in the district and sub-treasuries were kept with the Imperial Bank at its head offices and its branches until the establishment of the Reserve Bank in 1935, when they were handed over to that bank.

§8. **Business and progress of Presidency Banks.**—The Presidency Banks were excluded from (i) dealing in foreign exchange (except as regards Ceylon in the case of the Bank of Madras) and (ii) borrowing money abroad; lastly, (iii) there were certain restrictions as to the amount and period of the advances, as well as the securities against which they could be made.

All these restrictions and handicaps, however, did not prevent the Presidency Banks from prospering greatly. The restrictive provisions, while they hampered an even more rapid development than was actually achieved, conduced to the stability and strength of the banks. There was a steady growth in the amount of private deposits attracted by the banks, especially in the period before the war of 1914-18. Unlike the joint-stock banks in India, the Presidency Banks exhibited a strong cash position, keeping on an average cash reserves much over 30 per cent of their liabilities. The Government always kept some balances with the banks, which were usually in excess of the minimum fixed, and, wherever they had branches, the banks also did some general banking business for the Government, for which they received a fixed remuneration. Further, the banks undertook to provide special facilities for the encashment of the currency notes at their branches in order to popularize them. This association of the banks with the Government added greatly to their prestige and stood them in good stead since it attracted private deposits and banking business on profitable terms and helped them to acquire and maintain a position of pre-eminence in the banking system of India.

§9, **Exchange banks (Foreign banks).**—The Presidency Banks, as mentioned above, were prohibited from dealing in foreign exchange and from raising funds outside India. But both these matters assumed greater and greater importance with the expansion of the country's foreign trade, and there was ample room for another class of banks dealing principally with foreign exchange.

The Indian joint-stock banks rarely engaged in this business for lack of the necessary training and experience and the want of access to the London money market. Before 1914 the only important Indian joint-stock bank which had a branch in London, like the exchange banks, was the Indian Specie Bank, but its London branch was apparently opened in order to facilitate the bank's dealings abroad in silver and pearls. The Alliance Bank of Simla (liquidated in 1923) and the Tata Industrial Bank (amalgamated with the Central Bank of India in 1923) also did 'as much exchange business as any exchange bank in India during the first few years of its life'.[1] A few of the existing joint-stock banks do take some part in this business but have not yet developed it to any great extent.

The foreign exchange business has thus been virtually a monopoly of the foreign banks. The principal difficulties in the way of establishing branches at foreign centres are (i) lack of large capital to command credit in the money markets of these centres; (ii) initial loss in working until the foreign branches become self-supporting; (iii) absence of a dependable staff trained in international exchange work; (iv) hostility of foreign banks and (v) the existence of their head offices in India which makes it difficult for the Indian Banks to keep themselves in close touch with the international monetary conditions and secure import and export bills, and bills for collection. In 1936, the first Indian exchange bank (Central Exchange Bank of India) was opened in London by the late Sir Sorabji Pochkhanawala under the aegis of the Central Bank of India. It was amalgamated with Barclay's Bank, London, in 1938.

Owing to the predominance of England in the foreign trade of India and the fact that London was the financial centre of the world, the early exchange banks established in India were due to English enterprise and had their head offices in London. But later on, as the country was opened to every nationality, branches of the principal banks in some countries other than England were started. The disturbance in the course of Indian trade and the important position attained by some foreign countries, that had not counted for much before in the international trade of India, acted as a stimulus to foreign banks opening their branches here. So that although the exchange banks carrying on business in India have been mostly branch agencies of banks having their head offices in London, the number of those with their head offices in Continental countries, in the Far East, and in the United States, has tended to increase. The exchange banks can be classified as (i) those doing considerable business in India, and (ii) those which are merely agencies of larger banks doing business all over Asia.

§10. **The business and present position of the exchange banks.**—Originally the business of the exchange banks was confined almost exclusively to the financing of the external trade of India. But in recent years most of them have also taken a

[1] Sinha, op. cit., p. 220.

considerable part in financing the internal trade at the places where their branches are situated. They do a certain amount of business on the lines of any ordinary bank. But their main business in India is financing foreign trade by the purchase and discount of foreign bills of exchange. The import bills are negotiated in England and other foreign centres and are payable in India. But by far the greatest proportion of the bills in which the exchange banks deal are export bills drawn by Indian exporters against credits opened with the London banks or finance houses, by London importers. These bills, which are drawn usually at three months' sight, are mostly documents on acceptance (D.A.) though a few are documents on payment (D.P.). The D.P. bills are held by the London offices of the exchange banks until they are retired or paid on maturity. The D.A. bills are generally discounted or rediscounted immediately after acceptance. They are rediscounted in the United Kingdom by the English and Scotch joint-stock banks or by the Bank of England. In this way the exchange banks receive back in sterling the equivalent of what they paid in rupees in India. They may sometimes hold the bills till maturity in case trade is slack and there is no immediate demand for the employment of funds in India.[1] Thus the export trade of India is largely financed by the funds of the British banks. The facility of rediscounting bills in the London money market, where the rate of discount is usually lower than in India, is a great advantage, as the exchange banks buy far more export bills than they can possibly hold until maturity. The absence of this facility in the case of the Indian joint-stock banks makes it extremely difficult for them to compete with the foreign exchange banks whose large profits are protected by established and not easily assailable advantages.

The purchase of Indian export bills by the exchange banks means a transfer of their funds to London. To bring their funds back to India, the exchange banks were in the habit of freely purchasing Council Bills and Telegraphic Transfers in London, so long as this system lasted. Now they effect this transfer by selling sterling to the Reserve Bank of India against their London balances. There are other methods also by means of which they increase their funds in India, for example, by cashing import bills when they mature ; by the sale of drafts, and by telegraphic transfers in India for Indian students and travellers abroad and other persons requiring money to be remitted from India ; by buying rupee paper in London and selling it in India, and so on. In the last resort, when there is a strong favourable balance of trade, they import bars of gold and silver bullion and sovereigns from London, Egypt and Australia. In like manner, when the balance of payments is against India the exchange banks either send gold or silver out of India. Formerly they bought Reverse Councils if the Government of India made them available. Since the establishment of the Reserve Bank of India in April 1935, they can purchase sterling drafts from the Bank for delivery in London.[2]

The import trade of India is financed either by sixty days' sight D.P. drafts drawn on Indian importers or by London banks' acceptance of 'House paper'.

[1] The bulk of the bills between India and Europe, the United States of America and the colonies are drawn in sterling. Those between India and Japan used to be drawn in yen. Bills between India and China are drawn in rupees.

[2] For Exchange Control measures of recent years, refer to ch. ix, §29.

The former method is usually adopted in the case of imports by Indians. These drafts (which are drawn in sterling), after being discounted by the exchange banks in London, are sent to India for collection through the exchange banks who present them on the importers for acceptance and payment. Importers can, however, obtain delivery of the goods before payment by executing trust receipts in favour of the exchange banks and holding the goods as their trustees until the final payment. The second method is available to European importing firms who have London houses of standing. The latter draw bills on the London offices of the exchange banks which undertake to accept these bills, and thereafter they can be readily discounted in the London money market. The accepting banks in London forward the relative documents to their branches in India for the collection of the proceeds of the goods in India, and these are sent to London before the bills mature or when they are paid. In the financing of the import trade of India the more active part is played by the head offices and branches of the exchange banks outside India. The share of the Indian branches in the business consists primarily in collecting import bills at maturity, and in furnishing their branches with information as to the means and standing of the drawees of the bills. Import bills, unlike export bills, are as a rule not rediscounted in India, and thus the import trade is financed to a much greater extent than the export trade by the funds of the exchange banks. In order to develop a discount market for import bills it is necessary that these should be drawn in rupees and should preferably be D.A. bills. These reforms would also serve to redress the legitimate grievances of Indian importers in this respect.

Keynes pointed out that there is *prima facie* some danger to the stability of the Indian financial system in the fact that its money market is largely financed by funds raised not permanently, but for short periods, in a far distant foreign centre.[1] However, the greater success of the exchange banks in recent years in attracting an increasing volume of funds in India itself has to that extent diminished their dependence on the London money market.

Exchange Banks (Indian resources in lakhs of rupees)

	Deposits	Demand Deposits	Demand Deposits per cent of total deposits	Cash per cent of deposits
1939 ..	7,418	4,824	65	9·2
1940 ..	8,528	6,161	72	20·1
1941 ..	10,550	8,048	76	12·6
1942 ..	11,685	9,748	84	10·2
1943 ..	13,627	11,586	87	8·9

[1] *Indian Currency and Exchange*, p. 212.

Nevertheless, it is desirable in the interests of safety that the sums borrowed on relatively short notice either in England or in India should not exceed the assets located there.[1] An adequate cash reserve to meet their deposit liabilities is also necessary. An important event in recent banking history in India was the entry into India of one of the English 'Big Five', brought about by the acquisition of the business of Cox & Co. by Lloyds Bank.

The figures on the previous page show the position of the exchange banks in respect of their Indian resources from 1939 to 1943.[2]

§11. **Restrictions on foreign banks.**—The share of Indians in the foreign trade of India is estimated to be between 15 and 20 per cent of the total.[3] There is thus a considerable loss in the shape of commission, brokerage, and insurance paid to non-Indians. It is believed that this preponderance of the non-Indian element in the foreign trade of India is due to the large facilities given by the non-Indian exchange banks to their nationals operating in India. Also, as we have already seen, these exchange banks have almost a monopoly of the financing of the country's foreign trade and it is complained that they use their monopolistic position to the prejudice of Indian merchants.[4]

Certain witnesses before the Central Banking Enquiry Committee urged the regulation of the operations of the exchange banks in view of the fact that they were not subject to any legal restrictions in India and were exempt even from the limited statutory obligations imposed on Indian joint-stock banks registered in India, with the result that no separate information was available regarding their Indian business. It has also been urged that while they draw deposits in India, there is no protection extended to the Indian depositor; and lastly control is advocated on broad national grounds as in other countries, like Japan, with a view to supplying a corrective to the anti-Indian policy of the exchange banks and to removing the difficulties of Indian traders. (*C.B.R.*, 447.)

Provision exists in the laws of various countries for regulating foreign banks by means of licences granted by some prescribed authority in the country and the Committee advocated a similar system for India partly in the interests of depositors, partly for ensuring the grant of reciprocal treatment in foreign countries to Indian banks, and partly also for giving the Reserve Bank some control over the banks operating in this country. The Reserve Bank would be the most suitable authority for undertaking the task of scrutinizing applications from non-Indian

[1] Keynes, op. cit., pp. 212-13.

[2] See S. K. Muranjan, *Modern Banking in India*, 2nd ed., footnote p. 207.

[3] See Bimal C. Ghose, *A Study of the Indian Money Market*, p. 87.

[4] It was alleged by several commercial bodies in India before the Central Banking Enquiry Committee that the exchange banks furnish unsatisfactory bank references regarding Indian commercial houses to exporters abroad, that Indian importers fail to obtain D. A. terms, that Indian importing firms are required to deposit 10 to 15 per cent of the value of goods with the exchange banks in order to get a confirmed letter of credit opened (which is not the case with foreign houses), that import bills are drawn in sterling and carry a fairly high rate (six per cent) of interest, that the exchange banks discriminate against Indian steamship and insurance companies, that they do not offer responsible posts to Indians, etc. See *C.B.R.*, 439-45. The Report suggested that the Government of India should arrange suitable conventions with the exchange banks to meet the various complaints.

banks and for granting licences in approved cases. But the Committee held that, in fairness to the banks already established, licences should be freely granted to them. Every licence should be in force for a stated period and should be renewed if the licensing authority was satisfied that the provisions of the Indian law applicable to the bank, and other conditions specified in the licence, were complied with. The conditions of the licence which non-Indian banks wishing to do banking business in India should be required to take out, should be as follows :

(i) Furnishing the Reserve Bank with annual statements showing the assets and liabilities relating to their Indian business, as prescribed by the Reserve Bank.

(ii) Submitting, at any rate for a few years to come, to the Reserve Bank periodic reports of Indian and non-Indian business handled by them.

(iii) Other conditions might be imposed on the basis of reciprocity. There are various restrictions imposed by the laws of foreign countries on non-national banks working there. The power to impose similar conditions in the licences granted to non-Indian banks in India would enable the Government of India to accord reciprocal treatment to non-Indian banks. (*C.B.R.*, 451.)

§12. **Opening of an Indian exchange bank.**—However much the present position may be improved by such restrictions on foreign banks, they will not remove a fundamental source of weakness due to the very small share taken by Indians both in the import and the export trade and in the provision of banking facilities for such trade. The Central Banking Committee suggested the following measures for enabling India to obtain her legitimate share of both banking and trade (*C.B.R.*, 481). (i) Well-established Indian joint-stock banks should open foreign connexions useful to their clients (*C.B.R.*, 482). (ii) On the establishment of the Reserve Bank and the simultaneous withdrawal of the restrictions now imposed on the transaction of foreign exchange business by the Imperial Bank of India, the latter should be induced to take an active share in the financing of India's foreign trade. (The old restrictions on the transaction of foreign exchange business by the Imperial Bank of India have been removed since the establishment of the Reserve Bank on 1 April 1935: the former has also been appointed the sole agent of the latter.) (iii) If the Imperial Bank was unable to participate actively in the financing of India's foreign trade, the establishment of an Indian exchange bank was recommended (*C.B.R.*, 485). Such a bank should have a capital of Rs. 3 crores subscribed in the first instance by joint-stock banks registered in India. If the share capital is not fully subscribed within a prescribed time, the balance should be supplied by the Government, which should arrange gradually to dispose of their holding later to the general public. So long as the Government hold more than 50 per cent of the capital, they should have a predominating voice in the appointment of the directors. The question of entrusting the work connected with Government remittances to a department of the new bank working under the control of the Reserve Bank should be considered in consultation with the Reserve Bank subject to the stipulation that the new bank should not be allowed to make a profit on such remittances purchased in the open

market in its capacity as agent.[1] (iv) Banks controlled jointly by Indians and non-Indians as equal partners should be established.

§13. **History of joint-stock banks.**—The growing mass of internal commerce in India required organized banking of the modern type. Neither the Presidency Banks, which were semi-public institutions subject to various restrictions and which had branches only in a few large towns, nor the exchange banks, which were mainly preoccupied with foreign trade finance, were able to supply the need of the country in this respect. Until 1860, when the principle of limited liability was recognized for the first time in India, the progress of organized banking was slow. The financial crisis in Bombay caused by the cotton boom of 1865 and the fall in the exchange value of the rupee prevented substantial progress from being achieved. The earliest bank of this description was the Bank of Upper India (1863), which was followed by the Allahabad Bank, in 1865, and some more banks, one of which was the Alliance Bank of Simla (1874) which went into liquidation in 1923. In 1870, seven such banks were in existence. In 1894 the number rose to fourteen. Most of them were, and continue to be, under European management. The first bank due to Indian enterprise was the Oudh Commercial Bank, started in 1881. In 1894 the Punjab National Bank was established, mainly through the efforts of Lalla Harkishen Lal, who was also responsible for the establishment of the People's Bank in 1901. The People's Bank made great strides and at the time of its liquidation in 1913 it had nearly 100 branches and its deposits were over Rs. 1¼ crores.[2] One of the results of the advent of swadeshi in 1905 was a flood of new banks, especially in western India, the United Provinces and the Punjab. It was to this epoch that the Bank of India, the Bank of Burma, the Indian Specie Bank, the Central Bank of India, the Indian Bank (Madras), the Punjab and Sind Bank, the Bank of Mysore, the Bank of Baroda and the Bombay Banking Company owed their origin.

§14. **Bank failures.**[3]—In the first few years great progress was made by most of these banks, but the business of many of them was of so unsafe and speculative a character, and their cash reserves were so slender in proportion to their liabilities, that it was easy for a trained and gifted observer like Keynes to predict speedy disaster, and he had the melancholy satisfaction of very soon seeing his prophecy come true.[4] The failure of the People's Bank in 1913 was followed by numerous other failures, including that of the Specie Bank later in the same year. In the course of the year 1913-14 as many as fifty-five banks went into liquidation. The boom during and after the war of 1914-18 gave another impetus to new flotations,

[1] In a Minute of Dissent signed by six members of the Committee (including Sir Purshotamdas Thakurdas) it is urged that the state should forthwith start an exchange bank with a capital of Rs. 3 crores, all to be taken up by the state. (*C.B.R.*, 30).

[2] See B. T. Thakur, *Organization of Indian Banking*, pp. 31-2.

[3] For a very readable and lucid analysis of bank failures in India with special reference to some individual banks, see S. K. Muranjan, *Modern Banking in India*, ch. ix.

[4] In 1913, on the eve of the bank failures in India, Keynes wrote: 'In the case of the smaller banks, dealing as they are with clients to whom banking is a new field and in a country where hoarding is still dominant, the cash balances seem, from available indications, to be hopelessly inadequate; and it is hard to doubt that in the next bad times they will go down like ninepins.'—*Indian Currency and Finance*, p. 225.

but when the depression set in, a large number of failures took place. Eleven banks failed in 1915, thirteen in 1916 and sixteen in 1918. The years 1913-24 were a critical period for joint-stock banking in India. As many as 161 banks failed during this period, and the paid-up capital of these banks amounted to about Rs. 6¾ crores. Of the post-war failures, the most important was that of the Alliance Bank of Simla in 1923, which had far-reaching and disastrous consequences. In recent years the most outstanding case of bank failure was that of the Travancore National and Quilon Bank which went into liquidation in 1938. The closure of this bank, which was a scheduled bank, caused a banking crisis in South India at the end of June 1938, by creating nervousness among bank depositors as regards the position of other local banks, though other centres were fortunately unaffected. During the financial year 1938-9 as many as 64 banks went into liquidation or otherwise became defunct. The shock to public confidence, setback to habits of investment, and injury to industrial and commercial development were among the other serious consequences.

§15. **Causes of the bank failures.**—The causes of the failures, particularly of those which occurred in 1913-14, were (i) slender percentage of cash to deposit liabilities, the average being 10 to 11 per cent; (ii) unbusinesslike rates of interest offered in order to attract deposits to make up for paid-up capital; (iii) absence of a proper proportion between the authorized and the subscribed capital, and between the subscribed and paid-up capital; (iv) absence of able managers and directors with the required knowledge of banking business and practice, and lack of proper supervision by the Board of Directors;[1] (v) fraudulent dealing on the part of some of the directors and managers; (vi) the gullibility of the depositors who were easily misled by the window-dressing of balance sheets and the payment of high dividends even from capital; (vii) lack of palliative remedial action such as the Government themselves or quasi-Government agencies might have supplied; and (viii) absence of tradition of co-operation among the banks themselves.

Some critics foolishly hinted that the bank failures demonstrated the incapacity of Indians to conduct organized banking of the modern type. But it must not be forgotten that such failures were a common feature of the early history of joint-stock banking even in England and the United States, which are at the present time in the forefront in banking matters. Again, as Mr Doraswami remarks, 'the path of Indian Bank failures is strewn with the wreckage of European manned institutions',[2] and he instances the failure of the first Bank of Bombay (1868) and the Arbuthnot Bank, to which we may add the big failure of the Alliance Bank of Simla (1923). Although fraudulent manipulation was proved in some cases, the principal cause of the failures was lack of experience and knowledge. The failures enforced the lesson that banking is neither 'fool-proof' nor 'knave-proof', that it was necessary to minimize the risks of crisis by improving the banking machinery, by a careful selection of officers, directors and auditors, and adherence to sound banking methods.

[1] 'It was a case of an army going into battle without any trained officers and without any orders from the General Staff.'—Shirras, *Indian Finance and Banking*, p. 336.

[2] See S. V. Doraswami, *Indian Finance, Currency and Banking*, p. iii.

The bank failures of 1913-14 had at least one good effect, that they removed the weak spots in Indian banking, although some deserving banks also failed along with many undeserving ones. They further demonstrated the necessity of a central bank like the Bank of England to guide the general banking policy in a time of crisis and to see to it that in normal times banking is conducted on sane and sound lines. This defect in the banking system of India may be said to have been removed by the establishment of the Reserve Bank of India in 1935 (see §36).

The South Indian banking crisis of 1938 revealed the necessity of the scheduled banks maintaining closer touch with the Reserve Bank so as to give it a clearer idea of their position and working and put it in a position to extend credit to deserving institutions without delay.[1] It also revealed that one of the difficulties in the way of making advances to scheduled banks during such times was the absence of a sufficient quantity of rediscountable assets with them. The bank failures of 1913-14 and of subsequent years also showed how necessary it was to make suitable provision for thorough instruction in the theory and practice of banking. Equally important with good banking laws and well-trained bankers is wide publicity, to enable the public to make a shrewd guess as to the position of a bank's affairs at any given time. It is also essential that the banks themselves should develop high and honourable traditions and a sense of responsibility to the public.

§16. **Importance of adequate cash reserves.**—The maintenance of sufficient cash reserves is the very ABC of sound banking. But it is the experience of most countries that banks learn this salutary lesson only after a reckless disregard of it has actually caused a series of disasters. Indian joint-stock banking has already paid very heavy school-fees in the shape of bank failures but seems to have at least learnt the lesson thoroughly, and the laudable desire to maintain strong reserves has been latterly more and more in evidence. The matter is so important that the Bombay Banking Enquiry Committee suggested that banking agencies should be compelled by law, as in the United States of America, to maintain an adequate cash reserve. The Central Banking Enquiry Committee, however, did not favour this proposal. They were apprehensive that the statutory minimum might be regarded as the maximum by the management of the banks and that there were many ways of evading legal requirements. The Committee preferred to leave the matter to the good sense and discretion of the banks themselves. (*C.B.R.*, 706.) The amended (1936) Indian Companies Act, however, has made a provision for the keeping of minimum cash reserves (see §19 below) and the proposals for a Bank Act put forward in 1939 by the Reserve Bank of India are designed to ensure an adequate degree of liquidity of the resources of banks (see §20 below).

§17. **Growth of joint-stock banking.**—On 31 December 1937 there were 151 joint-stock banks in India having capital and reserve of Re. 1 lakh and over. Their paid-up capital was Rs. 7,73 lakhs, reserve and rest Rs. 6,27 lakhs, deposits Rs. 108,66 lakhs, and cash balances Rs. 18,13 lakhs. Out of these, six banks between them accounted for by far the greater part of the deposits. Leaving aside

[1] This was the first banking crisis which the Reserve Bank had to handle.

the Banks of Mysore and Baroda, which enjoyed State patronage, the remaining four institutions were really the sole important instances in India of purely private enterprise engaged in joint-stock banking. These were the Bank of India, the Central Bank of India, the Punjab National Bank, and the Allahabad Bank (Calcutta). Of these only the Central Bank of India and the Punjab National Bank were Indian-managed. Owing to the failures of 1913-14, banking received a setback; but beginning from 1915 there was a steady expansion of banking resources, especially of deposits, which reached the high figure of Rs. 80 crores in 1921. This expansion was partly due to the inflation of deposits during the war of 1914-18 and the post-war boom in banking company flotations. Between 1921 and 1923 there was a decline, especially marked in the year 1923 which was a black year for banks in the post-war period, after which recovery was noticeable. The economic depression did not on the whole adversely affect the deposit position of the banks, probably because of the lack of free investment of floating funds and of the transfer of a part of the proceeds of gold exports to banks. In recent years there has been considerable expansion of joint-stock banking, as is shown by the appreciable increase in deposits and the greatly increased activity in branch banking. Till recently the joint-stock banks received little encouragement from the Government and public bodies. After the establishment of the Reserve Bank of India in April 1935, the situation underwent a change for the better. The bigger banks (scheduled to the Reserve Bank of India) are qualified to receive assistance and advice from the Reserve Bank of India. Even the smaller banks (non-scheduled) may receive the benefit of the advice of the Reserve Bank, provided they satisfy certain requirements (see §§42-3 below).

Two important events in the history of Indian joint-stock banks which occurred in 1923 deserve special notice. The first was that the Tata Industrial Bank, started in 1918, was merged in the Central Bank of India, which has established its position under capable Indian management as one of the leading joint-stock banks in the country. This constitutes an exception to the general tendency in Indian banking which is against such mergers or amalgamations.

The second event which dominated the banking situation in 1923 was the failure of the Alliance Bank of Simla. The Imperial Bank of India undertook to pay the depositors of the Alliance Bank 50 per cent of the amount due to them, on receiving a guarantee from the Government of India that they would meet the losses consequent upon the failure. The Government's justification for intervention was that the failure of such a bank would have been disastrous to other banks, and that, if the panic had not been averted by prompt action, Indian banking would have received another serious setback. The critics of the Government contrasted the attitude of zealous sympathy displayed by them as well as by the Imperial Bank towards the Alliance Bank with the indifference shown towards the Indian joint-stock banks which came into trouble in the crisis in 1913-14.

We have already noticed the failure in 1938 of the Travancore National and Quilon Bank and the South Indian banking crisis which fortunately did not have adverse reactions on the position of Indian banking in other provinces. At the same time the failure of a scheduled bank caused considerable uneasiness in the country and prominently raised the question of the relations between the Reserve

Bank and the scheduled banks on the one hand, and on the other, of comprehensive banking legislation[1] (§20). The effects on Indian banking of the wars of 1914-18 and 1939-45 are dealt with later in the chapter.

There is great scope for the expansion of joint-stock banks in the country under the guidance of the Reserve Bank. The joint-stock banks can themselves learn much from their competitors on both sides. As the Central Banking Committee pointed out, they should combine the economical management of the indigenous bankers with the efficiency and modern methods of the Western institutions. (*C.B.R.*, 568.)

§18. **Regulation of banking.**—In view of the alarming succession of bank failures described above, and for securing the development of banking on sound national lines, it is generally felt that purposeful regulation is necessary. The position in India in this respect until 1936 was unsatisfactory, the Government following the traditional policy of *laissez-faire*. The joint-stock banks were governed until 1936 by the Indian Companies Act of 1913 in common with other joint-stock companies, and only a few sections of this Act had a special bearing on joint-stock banking. Besides, all that the old Act required was the observance of a few formalities in the matter of preparation of the balance sheet, and the form in which the statement of affairs was to be published twice a year.

The Central Banking Enquiry Committee carefully reviewed the question and formulated a scheme of regulating joint-stock banks in India. They recommended that a special Bank Act be passed comprising the existing regulations embodied in the Indian Companies Act with certain modifications and additional provisions relating to (i) Organization; (ii) Management; (iii) Audit and Inspection; and (iv) Liquidation and Amalgamation.[2]

§19. **Special provisions relating to banking companies in the amended Indian Companies Act (1936).**—After a delay of nearly five years the Government of India decided to incorporate special provisions relating to banking companies in their Indian Companies (Amendment) Bill, which became law in 1936. This course was adopted by the Government in preference to a special Bank Act on the ground that there was no immediate prospect of legislation dealing solely with this subject being undertaken. Moreover the major banks had already been dealt with partly in the Reserve Bank Act. The recommendations of the Central Banking Enquiry Committee were considered in drafting these new provisions, which are as follows:[3]

(i) A banking company has been defined as one which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order notwithstanding that it engages in addition in any or all of certain specified forms of business, such as lending of money, discounting bills, buying or selling foreign exchange, granting

[1] For an instructive criticism of the part played by the Reserve Bank of India in the South Indian banking crisis and of its attitude towards the Travancore National and Quilon Bank, see S. K. Muranjan, *Modern Banking in India*, 1st ed., pp. 285-8.

[2] See *C.B.R.*, ch. xxv; also M. L. Tannan, *Regulation of Banks in India*.

[3] Act XXII (an Act further to amend the Indian Companies Act 1913, for certain purposes) of 1936, Part XA, sections 277F to 277N.

letters of credit, receiving valuables for safe custody, underwriting and dealing in stock, shares, debentures, etc., promoting or financing any business undertaking through syndicates or otherwise, undertaking and executing trusts. (ii) The activities of such banking companies are restricted to ordinary banking transactions by requiring the Memorandum of Association to make provision to this effect as a condition of registration under the Act. (iii) The employment of managing agents for the management of banking companies in future is prohibited. (iv) Certain minimum working capital before business is commenced is ensured by making necessary the issue of a certificate to the effect that working capital of Rs. 50,000 has been obtained by the allotment of share capital. (v) A banking Company is not allowed to create any charge upon its unpaid capital. (vi) A Reserve Fund is made compulsory by requiring a transfer out of the annual profits, before any dividend is declared, of a sum not less than 20 per cent of such profits to the Reserve Fund until the Fund equals the paid-up capital. (vii) A minimum Cash Reserve of $1\frac{1}{2}$ per cent of the time liabilities and 5 per cent of the demand liabilities is to be maintained, and monthly statements of the amount so held and of the time and demand liabilities are to be filed with the Registrar by banking companies other than scheduled banks. (viii) A banking company is not allowed to form or hold shares in any subsidiary company except a subsidiary company of its own formed for the purpose of undertaking and executing trusts, or for undertaking the administration of estates, and for such purposes as are incidental to the business of accepting deposits. (ix) Provision has been made for a moratorium to save from liquidation a banking company in temporary difficulties by authorizing the Court on the application of a banking company to stay proceedings against such a company, provided the application is accompanied by a report made by the Registrar. The latter is entitled for the purpose to investigate the financial condition of the company at its cost.

§20. **Recent legislation for the regulation of banking.**[1]—While the new legislation was a step forward in the direction of regulating banking in India, there was still need for a separate Bank Act. Certain proposals submitted to the Government by the Reserve Bank in November 1939 were based on the general principle that the primary objective must be to safeguard the interest of the depositor, and thus ensure the economic development of the country by promoting the banking habit. They aimed at establishing a network of properly run and financially sound banking institutions which would enable the Bank to co-ordinate the credit structure of the country and more fully utilize the powers of extending credit provided by the Reserve Bank Act.

A Bill modelled on the proposals of the Reserve Bank (the Banking Companies Bill, 1945) was adopted by the Assembly on 11 April 1945. But it lapsed owing to the dissolution of the Assembly and had to be reintroduced in the newly elected Assembly on 15 March 1946. It was modified in certain respects in the light of public opinion so as to give the Reserve Bank greater control over banks.

Pending enactment of the Bill by the Legislative Assembly, the Central Government issued an Ordinance on 15 January 1946 [Banking Companies

[1] See *Report on Currency and Finance*, 1948-9, par. 95.

(Inspection) Ordinance 1946] empowering the Government to take corrective action if after perusing the Reserve Bank's report of inspection it considered that the affairs of a banking company were conducted to the detriment of its depositors. The Government might, wherever necessary, prohibit the banking company concerned from receiving fresh deposits or refuse its inclusion as a scheduled bank or direct its exclusion from the schedule if it was already included. Pending the enactment of the Banking Companies Bill and with a view to controlling the unplanned expansion of branches[1] and checking certain undesirable developments such as excessive expenditure on branches in relation to their resources, employment of untrained staff, etc., the *Banking Companies (Restriction of Branches) Act*, 1946, was passed and became effective from 22 November 1946. The Act lays down that no banking company shall open a new branch or change the location of an existing branch without prior permission from the Reserve Bank which, before giving such permission to any bank, would consider its financial condition and history, the general character of its management, the adequacy of its capital structure[2] and earning prospects and the public interest to be served by the branch; and if necessary, and with the previous approval of the Central Government, cause an inspection to be made of the books of account and other documents of the bank.[3]

The Banking Companies (Control) Ordinance, 1948, sought to bring into immediate operation some of the provisions of the Banking Companies Bill so as to enable the Reserve Bank to regulate the banking system more effectively. It authorized the Reserve Bank to grant emergency advances against such security as it deemed adequate and to issue directives to banking companies in regard to their lending policies in general and any transaction in particular. Banking companies were required to maintain, at the end of each quarter, assets in India of not less than 75 per cent of their demand and time liabilities in India. Amalgamations or schemes of arrangement or compromise between banks were made subject to the concurrence of the Reserve Bank. The Reserve Bank was empowered to call for periodic and *ad hoc* returns relating to banks and to publish them in the public interest. The Ordinance also provided for the appointment of the Reserve Bank, if it applied for it, as official liquidator of a banking company by a Court.

Banking Companies Act, 1949: The Banking Companies Bill was at last passed by the Indian Parliament on 17 February 1949 and came into force from 16 March 1949. It consolidates and supersedes previous laws and ordinances since 1913 for the regulation of banking including the relevant provisions of the Indian Companies Act 1913. It also contains several new provisions :

(i) The Act applies to all banking companies, except co-operative banks, and extends to all the provinces of India and the Acceding States so far as the Indian Parliament has power to make banking laws for such States. The Act

[1] In the first quarter of 1946 new branches opened by scheduled banks alone were 79; from April to June 1946 the figure was 73; and from July to September, 140.

[2] In one glaring instance a bank with a paid-up capital of Rs. 24,000 had 34 branches and had declared a dividend of 5 per cent. It was not surprising that its depositors discovered that it was easier to put in deposits than to take them out !

[3] See *Reports on Currency and Finance*, 1945-6 and 1946-7.

defines banking as 'the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise'. Such a simple definition was necessary for limiting the scope of legislation to institutions in which funds were deposited to ensure their safety and ready withdrawability and for getting over the difficulty of interpretation caused by the words 'principal business' in the definition given in Section 277 of the Indian Companies Act of 1936.

(ii) All banks coming within the scope of the Act are to be licensed by the Reserve Bank after making sure of the soundness of their financial position. In the case of a foreign bank, no licence is to be issued if the law of the country in which it is incorporated discriminates against banking companies registered in India.

(iii) The Act lays down minimum requirements relating to paid-up capital and reserve of a banking company according to the geographical coverage of its operations.

(iv) Under the Act even non-scheduled banks are required to keep minimum reserves in cash with themselves or the Reserve Bank (2 per cent of time liabilities and 5 per cent of demand liabilities) and to submit monthly returns of cash and time and demand liabilities as on each Friday.

(v) All the banking companies are required, two years after the commencement of the Act, to maintain at least 20 per cent of their time and demand liabilities in cash, gold or unencumbered approved securities valued at current market rates. They have also to maintain in their respective areas at least 75 per cent of their time and demand liabilities at the end of each quarter.

(vi) The Act prohibits interlocking directorates among banking companies and the employment of managing agents, as well as the granting of unsecured loans or advances to any of the directors or to firms in which the directors are interested.

(vii) The Reserve Bank has now the following statutory powers and duties: (*a*) issuing directives to banks regarding lending policies concerning objects of loans, margins to be maintained and rates of interest to be charged; (*b*) issuing warnings against or forbidding any particular transaction or class of transactions; (*c*) calling for and publishing periodical and *ad hoc* returns; (*d*) inspecting banks on its own initiative or under instructions from the Government; (*e*) granting or withholding permission to open new branch offices or transfer existing ones; (*f*) asking for appointment as the official liquidator by a Court in any proceedings for the winding-up of a banking company; (*g*) making an annual report to the Central Government on the trend and progress of banking in the country and suggesting measures for strengthening it.

§21. **Clearing houses.**—The system of 'clearing houses' was introduced in England towards the last quarter of the eighteenth century. It made possible the easy adjustment of countless cross claims without actual use of cash or money. The existence of this system explains to a large extent the phenomenal development of the cheque system in England and other countries. For the greater success of this system, it is necessary that one of the member-banks of the clearing house should act as the settling bank or the 'bankers' bank', the other banks

keeping a balance with it so that the settlement of cross claims is rendered more easy and complete.

The principal clearing houses in India were those of Calcutta, Bombay, Madras, Karachi and Rangoon (before the separation of Burma and Pakistan). Clearing houses were also established in Cawnpore, Lahore, Delhi, Simla and Ahmedabad. At many places where there is no clearing house, a system is in vogue of clearing accounts by giving cheques on the Imperial Bank in payment of balances due between the banks in the place. The Reserve Bank, the Imperial Bank, the exchange banks, the English banking and agency firms and the leading Indian joint-stock banks are most of them members of clearing houses. The Reserve Bank of India acts as the settling or bankers' bank. A representative of each member-bank attends the meeting of the clearing house on every business day at certain times. As the members have usually an account with the Reserve Bank, the final balance left over after the cancellation of cross claims is usually settled by cheques and book entries, thus dispensing with cash in any form. Mr McDonald, then Managing Governor of the Imperial Bank, suggested in his evidence before the Central Banking Committee that an Association of Clearing Banks should be incorporated. It should have its own rules and manage every clearing house in detail; it should have its own bankers, as should every member. In India these functions were, until the establishment of the Reserve Bank of India, largely performed by the Imperial Bank. There was thus confusion, and not infrequently other banks regarded their accounts with the Imperial Bank as being nothing more than a part of the clearing house and a means of settling their differences in the clearing, and overlooked that in addition to the balance required to meet their clearing differences, their balances should have covered the work involved, as in the case of an ordinary constituent. The use of the cheque is still in its infancy, being practically confined to the commercial towns. Nevertheless, it is gradually finding its way even into the mofussil areas, and the tendency has been especially marked since the establishment of a number of branches by the Imperial Bank. The cheques issued by the co-operative banks are also familiarizing the public in up-country districts with the new system. To popularize and extend the clearing house system, more facilities must be given for the clearing of cheques of private firms up-country, and the privileges of the clearing house extended to registered private banks of suitable status. The use of cheques, although it is growing, is far from being commensurate with the vast size of the country and its population. One of the hindrances to the growth of the system is widespread illiteracy. Besides, in order to write a cheque, a person must not only be literate but must also know English. This is capable of being remedied if the joint-stock banks modify some of their methods and make use of the Indian languages in their transactions, particularly in respect of cheques, pass books and deposit receipts.[1] But the greatest hindrance is the deficiency of banking facilities. The following are some of the suggestions made by the Bombay Banking Enquiry Committee to popularize the use of cheques : (i) Cheques should be accepted in payment of land revenue, local rates and taxes ; (ii) the Imperial Bank should revive the policy of charging low rates of exchange on up-country cheques ; and (iii) joint-stock

[1] The abolition of the stamp duty on cheques has encouraged their use.

banks and co-operative banks should allow moneys to be withdrawn from savings banks accounts by cheques.[1]

§22. **Postal Savings Banks, etc.**—Government Savings Banks were established in the Presidency towns between 1833 and 1835. In 1817 District Savings Banks were instituted in connexion with certain select district treasuries. The Post Office Savings Banks were opened in all parts of India in 1882 and 1883, and absorbed the District Savings Banks' business in 1886 and that of the Presidency Savings Banks in 1896. The Government Savings Banks are, therefore, at present a department of the postal administration. The Government do not maintain any specific cash reserve to meet their deposit liabilities, which constitute therefore an unfounded debt used for capital expenditure. The Postal Savings Banks provide the people of the middle and lower middle classes with a secure means of depositing their small savings, for which the general balances of the Government constitute a sufficient security. Agricultural and industrial workers appear to make a negligible use of these banks. In 1914, the Government offered increased facilities to depositors by raising the limit of the amount of the annual and total deposits permissible to an individual depositor as well as by helping the depositors in their investments in Government securities. This resulted in attracting large deposits, especially because public confidence in private banks had been badly shaken on account of the bank failures of 1913-14. The war of 1914-18 gave a temporary setback to Savings Banks deposits, but there was an improvement in the position in the post-war years. The amount of deposits during the period before the war of 1914-18 has been exceeded since 1922-3 (when it was Rs. 23·19 crores), though the position is less satisfactory than it looks if we consider the period which saw a fall in the purchasing power of the rupee. The deposit balances in recent years have shown a large increase—a result attributed to the investment of part of the proceeds of the sales of gold. Withdrawals in September 1939, when war broke out, were heavy and amounted to Rs. 7·95 crores. But with the revival of confidence there was an improvement in subsequent months.

There is considerable scope for the expansion of Post Office Savings Banks, seeing that in 1937-8 there were only 12,631 Savings Banks for nearly five lakhs of villages in British India, which shows that in the case of a vast number of villages the nearest Savings Bank is several miles away, making it highly inconvenient for the village folk to deposit their savings there. In 1941 the Post Offices offered to receive special Defence Savings deposits at a higher rate of interest.

Among the suggestions made for making the Post Office Savings Banks more popular are the following: (i) a higher rate of interest on deposits; (ii) a further relaxation of the restriction of the amount deposited annually and the limit on balances, subject to suitable precautions regarding sudden withdrawals;[2] (iii) the acceptance of deposits in the form of cheques and also the allowing of

[1] See *Report of the Bombay Provincial Banking Enquiry Committee*, pars. 303-6.

[2] The amount that can be deposited into an account in a single year is limited to Rs. 750 and the total balance to Rs. 5,000. The minimum amount that can be deposited at any time is four annas, withdrawal being permitted only once a week. The rate of interest was reduced from 3 per cent to 2½ per cent in 1933, to 2 per cent in 1936 and to 1½ per cent in 1938.

withdrawals by means of cheques ; (iv) propaganda for opening new Savings Banks offices.

The Post Office comes into contact with the savings of the people in another way, namely through Cash Certificates. These certificates are issued in amounts of Rs. 10 or multiples of Rs. 10, Rs. 10,000 being the maximum limit for the face value of the total holdings by one person. They are payable after 5 years from the date of purchase and are issued at a discount, full interest, i.e. face value, being payable only at the end of five years. Since the time of the war of 1914-18 a Government Loan branch has also usually been tacked on to the Post Office. As regards the Post Office Cash Certificates the system is capable of being extended and further popularized so as to make it finance a considerable portion of the provincial capital expenditure. In 1930-1 the amount of the Postal Cash Certificates outstanding was Rs. 38·44 crores, whereas it was only Rs. 13·12 crores in 1924-5 and Rs. 8·88 crores in 1917-18, when the system was first introduced. Prior to 1934-5 the amount of Cash Certificates outstanding greatly increased, being Rs. 65·96 crores on 31 March 1935. This result has been attributed partly to higher rates of interest prior to 1934-5 during which year the yield was reduced twice in conformity with the lower yields of gilt-edged securities and partly to the sale of gold at high prices and the investment of the proceeds in Cash Certificates. With the lowering of interest rates, there set in a tendency towards a decline in the value of new certificates, which was to some extent counteracted by a reduction in the interest rate on Post Office Savings Bank Deposits after December 1938. The total value of Cash Certificates outstanding on 31 March 1939 was Rs. 59·57 crores (excluding Rs. 0·59 crores in Burma). On the outbreak of war in September 1939, repayments during that month were very large. At the same time sales of Cash Certificates showed a sharp decline. With the return of confidence the situation showed an improvement especially in respect of repayments. The total value of outstanding Cash Certificates amounted to Rs. 39·22 crores in 1946-7 and to Rs. — 7·50 crores in 1948-9 (Preliminary).

Ten-year Defence Savings Certificates were introduced in 1940 [amounts outstanding were Rs·5·48 crores in 1946-7 and Rs. — 76 lakhs in 1948-9 (Preliminary)]. They were replaced by Twelve-year National Savings Certificates from 1 October 1943 [amounts outstanding were Rs. 70·62 crores in 1946-7 and Rs. 25·01 crores in 1948-9 (Preliminary), inclusive of five-year and seven-year National Savings Certificates issued from 1 June 1948]. The Defence Savings Bank started operations from 1 April 1941 and deposits amounted to Rs. 10·93 crores in 1946-7 and to Rs. — 4·07 crores in 1948-9 (Preliminary).

It was agreed between the Governments of India and Pakistan that facilities for the transfer of Post Office Cash, Defence and National Savings Certificates issued before 15 August 1947 and standing registered at Post Offices in one Dominion to Post Offices in the other Dominion should be allowed up to 30 June 1949. Certificates outstanding as on 15 August 1947 and verified for transfer by the office of issue on or before 31 March 1949 would be the financial liability of India to be adjusted as part of the general debt settlement and would be treated as if they had been issued before the partition in a Post Office now located in India. The Certificates transferred after 31 March 1948 would be the liability of the Domi-

nion in which the original office of issue is located: their discharge and bonuses thereon would, on payment, be recovered from the Dominion from which they were transferred.

On the basis of agreements reached at the Inter-Dominion Conference held in Delhi in November 1948, it was decided to allow transfer of Savings Bank accounts standing open at post offices in Pakistan to post offices in India and vice versa in respect of applications received up to 31 March 1949, irrespective of the date on which the account might actually be transferred.[1]

§23. **Effects of the war of 1914-18 on Indian banking.**—One of the effects of World War I on Indian banking was a remarkable increase in bank deposits. The total bank deposits of all the banks (the Presidency Banks, joint-stock banks and the exchange banks)[2] amounted to Rs. 97·51 crores in 1913 and Rs. 163·62 crores in 1918.

The large war profits made by some industries, like the cotton-mill and jute-mill industries, naturally increased the cash deposited with the banks. In addition the banks gave credit, both to the Government and private individuals and bodies, in connexion with the issue of and investment in War Loans and Treasury Bills. The banks gave credit to the Government by themselves subscribing to the War Loans and the Treasury Bills, and the Government drew upon this credit by issuing cheques on the banks to its creditors from whom heavy purchases of war materials, etc., had been made. These cheques were in their turn carried to their accounts at the banks by the Government's creditors. The banks thus found that their deposits increased by the amount of their subscription to the Government loans. The banks helped private persons and bodies to invest in War Loans and Treasury Bills by opening deposit accounts with them. Thus both these sets of causes served to increase enormously the total amount of the deposits. Another effect of the war was the worsening of the pre-war situation as regards the smallness of the capital of the banks in relation to the business transacted. This was due to the excessive anxiety of the banks to make larger and ever larger net profits by as rapid a turnover of their capital as possible. Further, the war witnessed a very considerable growth in the cash reserves of the banks, partly owing to the increase in the deposits and partly to the necessity felt by the banks to maintain stronger reserves as a safety measure under the abnormal war conditions and as a result of the banking crisis of 1913-14, the memory of which was still fresh and vivid. There was also a considerable increase in the investments of the banks, partly owing to the great activity of the export trade, but primarily as a result of the banks' investments in War Loans and Treasury Bills. The war brought higher dividends, tighter money and high bank rates, and a great increase in the amounts of cheques cleared. Lastly, the experiences of the war imparted greater urgency than ever to the question of a central bank, the need for which had already been clearly indicated by the crisis of 1913-14.[3]

§24. **Characteristics and deficiencies of the Indian money market.**—The

[1] See *Report on Currency and Finance*, 1948-9, par. 78.

[2] In the case of the exchange banks, only the deposits in India are taken into account.

[3] The effects of World War II on Indian banking are reviewed later in the chapter (see §50).

money market in India exhibits several characteristics and deficiencies, some of which are reviewed below. In the first place, as previously pointed out, the money market in India is divided into several segments which are loosely correlated to each other. Each sectional agency such as the Imperial Bank, the exchange banks, the joint-stock banks, the co-operative banks, the indigenous bankers, etc., limits itself to a particular class of business and remains virtually independent in its own sphere.[1] The relation between the various members of the money market are not very happy. Thus the joint-stock banks are jealous of the privileged position of the Imperial Bank, which until the establishment of the Reserve Bank performed to a limited degree the functions of a central bank. The exchange banks occupy a very strong position, and complaints are often heard that they encroach on the province of the joint-stock banks. Before their inclusion in the list of scheduled banks they were not amenable to any law or authority in India. The link between the co-operative and other banks is also very loose. But the most serious cleavage exists, as already shown, between organized banking institutions and indigenous banking. Even the latter or the bazaar part of the money market is not one compact entity, but is further subdivided, as, for example, in Bombay where there are separate Gujarati, Marwari and Multani bazaars, each with its own rate of interest. The absence of a genuine central bank until April 1935 aggravated the separatist and centrifugal tendencies; and although the Reserve Bank of India has long been at work no revolutionary changes can be expected in the near future. Firstly, because the relation of the Reserve Bank to indigenous bankers has not yet been settled; and secondly because before a well-organized and close-knit money market is brought into existence a certain amount of time must necessarily elapse, in order that the influence of the new central banking structure, imperfect as it is, should permeate the credit organization of the country.[2]

§25. **Confusion and chaos of money rates.**—An inevitable result of the sectional organization of the money market in India is the confusion and chaos of the money rates. The Central Banking Enquiry Committee cannot be said to be guilty of exaggeration when they say: 'The fact that a call rate[3] of $\frac{3}{4}$ per cent, a *hundi* rate[4] of 3 per cent, a bank rate[5] of 4 per cent, a Bombay bazaar rate[6] for

[1] This criticism applies specially in the period before the establishment of the Reserve Bank.

[2] Another defect of the Indian money market before the inauguration of the Reserve Bank of India was the dual control over the money market by the Government, which was the currency authority, and the Imperial Bank, which was the credit controlling agency to a limited degree. Further the Government dominated the money market by their currency and financial operations. The inauguration of the Reserve Bank, which is both the currency and credit controlling authority, has removed these two defects.

[3] The call or call money rate refers to the interest rate charged on surplus money seeking employment for a possibly minimum period of 24 hours.

[4] The (Imperial Bank) *hundi* rate is the rate at which the Imperial Bank will discount first-class three months' bills.

[5] The bank rate (old) refers to the rate at which the Imperial Bank, before the establishment of the Reserve Bank of India, was prepared to grant demand loans against Government securities. This is now known as the advance rate of the Imperial Bank. The basis of the bank rate as now quoted by the Reserve Bank is explained in §46 below.

[6] The bazaar rates are those at which the bills (*hundis*) of small traders are discounted by the shroffs at Calcutta and Bombay.

bills of small traders of 6¾ per cent and a Calcutta bazaar rate for bills of small traders of 10 per cent can exist simultaneously indicates an extraordinary sluggishness in the movement of credit between the various markets.'[1] This presents a marked contrast with the close relation between the various money rates in the London money market, all of which depend ultimately on the bank rate and promptly adjust themselves to changes in that rate. The old bank rate charged by the Imperial Bank, though quoted in financial journals along with the bank rates of the central banks of other countries, had a different and limited significance. Whereas the rates of the central banks usually denote the rates at which first-class trade bills can be discounted at the central bank, the Imperial Bank rate was not a discount rate but a loan rate. The divided control over currency by the Government and credit by the Imperial Bank before the inauguration of the Reserve Bank made the confusion of rates worse confounded. Another characteristic of the money rates in India is the perceptible disparity in respect of them at the two principal centres, Bombay and Calcutta, leading to fluctuations in the prices of securities and reactions on trade movements. This is brought out by the table of money rates below.

Indian Money Rates per cent[2]

On 1st of	Bank Rate	Call Money Rate		Imperial Bank *Hundi* Rate	Bazaar Bill Rate	
		Calcutta	Bombay		Calcutta (Range)	Bombay
April 1939 ..	3	2	2¼	3	6-7	5¼
May ,, ..	3	2	2	3	6-7	5¼
June ,,	3	1¼	¾	3	6-7	5¼
July ,, ..	3	½	½	3	6-7	5¼
August ,, ..	3	¼	¼	3	6-7	5¼
Sept. ,, ..	3	¼	¼	3	6-7	6
Oct. ,, ..	3	1	¾	3	6-7	5¼
Nov. ,, ..	3	½	½	3½	6-7	5¼
Dec. ,, ..	3	1	1¼	3½	6-7	6⅜
Jan. 1943 ..	3	½	¼	3	6-7	5¼
Feb. ,, ..	3	½	¼	3	6-7	5¼
March ,, ..	3	½	¼	3	6-7	5¼
March 1947 ..	3	½	½	3	9-10	7½
March 1948 ..	3	½	½	3	9-10	7½
March 1949 ..	3	½	¾	3½	12-15	8¼

We may now consider further the question of the relation between the old (Imperial) bank rate and the bazaar *hundi* rates.

We have already remarked that the indigenous banker finances the movement of crops during the busy season largely from his own resources. He is, however, ultimately dependent upon the Imperial and the other joint-stock banks for the additional funds he requires. Therefore in times of stringency the bazaar rate for first-class *hundis* follows the Imperial Bank rate. As we have seen, the shroffs who do the *hundi* discounting business charge higher rates than the bank rate, profiting by the difference between the two rates. Towards the beginning of the slack season the bank rate is generally higher than the *hundi* rate. When

[1] See *C.B.R.*, 579.

[2] See Statements xxix, xxiii, xxi and xxix in the *Reports on Currency and Finance* 1939-40), (1943-4), (1946-7) (1947-8) and (1948-9).

money is easy the correspondence between the two rates is less close than when it is tight, and the shroffs may disregard the bank rate and may underquote the bank.[1] It should be noted in connexion with the absence of complete harmony between the two rates that the shroffs scarcely ever discount European paper and do not purchase foreign or sterling bills. 'Neither do they lend money on Government paper or similar securities, but confine their advances to the discount of *hundis*, to loans to cultivators and against gold or silver bullion.' The banks do not compete with the shroffs for the purchase of traders' *hundis* and so there is often little apparent relation between the shroffs' rate and the bank rate. The shroff's reliance on banking funds is not sufficiently continuous or sufficiently great for the two rates to be closely similar. The operations of the shroffs still lie to a great extent outside the banking system of the country. The natural link between the Indian money market or the bazaar, and the market controlled by banking institutions of the European type would be 'a steady supply of trade bills endorsed by reliable firms or discount houses which are in touch with both markets and are able to meet the needs at one end of the merchant who prefers the elastic methods of bazaar finance, and to take advantage at the other end of entry into the central money and discount markets'. (*C.B.R.*, 581.)

The levelling down of the various money rates must be a matter of slow growth and development. 'The ultimate ideal must be the mobilization of the whole of the floating resources of the country into one large pool, into which bills can find their way with as little delay and with the intervention of as few intermediaries as possible.'[2] With the inauguration of the Reserve Bank it was hoped that the establishment of a bill market would be promoted, putting an end to the chaos of money rates and curbing the uncontrolled rates prevailing in the money market (see §§ 27-8 below).

§26. **Seasonal monetary stringency.**—Another striking characteristic (incidentally referred to above) of the money market in India is the seasonal monetary stringency and high money rates during a part of the year. The year in India is divided into two more or less distinct periods : (i) November to June, which is the period of the busy season when money is required to move the crops from the up-country districts to the port towns and internal centres of consumption, and (ii) from July to October, which is the period of the slack season when the money returns to the financial centres in payment for bullion or other commodities. There are wide fluctuations of the money rates from one period of the year to another, and the spread between the maximum bank rate during the busy season and the minimum during the slack season is very striking. For instance, the highest bank rate in the year 1924 was 9 and the lowest 4, corresponding figures for 1928 being 7 and 5, for 1929, 8 and 5, for 1930, 7 and 5. During the years of depression the bank rate remained at a comparatively lower level and without any change during the whole year, for example, during 1933-4 and 1934-5 the bank rate remained unchanged at 3½ per cent. This may be attributed to the general slackness in the trade demand, the prevailing low level of commodity prices, the release of frozen credit wrought by the sale of gold, and to some extent the feeling of ease

[1] See Shirras, *Indian Finance and Banking*, pp. 341-2.

[2] *C.B.R.*, 581

caused by expansion of currency. The Reserve Bank of India was compelled to reduce the bank rate to 3 per cent with effect from 28 November 1935 under pressure of easy conditions and weight of money awaiting investment. It has since remained unaltered, in spite of the disturbing conditions created by the outbreak of the war in September 1939, thanks to the new technique of financing the war.[1]

The bank rate[2] varies with the intensity of the demand for money, which again depends upon the nature of the harvest, the briskness of the demand for the great staples of agriculture (cotton, jute, wheat, rice, etc.), especially for export purposes, and the range of prices prevalent for them. We have already seen how the crops are financed in the earlier stages by the indigenous bankers and how a considerable volume of business is thus brought by them to the Imperial and other banks who discount and rediscount the shroffs' *hundis*. The demand for moving the crop[3] occasions a seasonal stringency in the money market, further emphasized by the great demand for currency which comes at the same time in connexion with holidays, marriage ceremonies, etc. But apart from these causes accounting for seasonal stringency, there were other factors responsible for the normal high money rates in India before the economic depression. We have already spoken about the part which the Reserve Treasuries played in causing monetary stringency. The transfer of large cash balances to the Imperial Bank (now to the Reserve Bank) brought some relief to the money market. The Government monopoly of note-issue and its divorce from banking, until its transfer to the Reserve Bank of India in 1935, was responsible for a maladjustment between the supply of and demand for money. A limited degree of elasticity was imparted to the note-issue by the provision for the seasonal issue of currency up to Rs. 12 crores against inland bills of exchange, under the Paper Currency Act of 1923.[4] The monetary stringency was also attributed to the heavy borrowings of the Government in the money market after the war of 1914-18 which prevented the Imperial Bank from collecting sufficient surplus cash, and thus the money rates remained unduly high. The exchange policy of the Government, involving deflation or refusal to allow the normal increase in currency, also added to the monetary stringency from time to time. But from the nature of the case this cause comes into operation only occasionally. On the other hand, the purchase of sterling in India, arrangements for cheap inland remittances, and the starting of additional branches by the Imperial and other banks, have had the effect of lowering to some extent the pitch of money rates during the busy season. However, the normal rate for money in India is still far too high and acts as a discouragement to business activity. A

[1] For further particulars regarding the effect of World War II on money rates in India, see §50.

[2] The old Imperial Bank rate varied inversely with the Government cash balances, which get depleted during the busy season, and begin to swell during the slack season.

[3] In connexion with the movement of crops during the busy season the following five methods of inland remittance may be distinguished: (i) remittance by *hundis* or cheques; (ii) transfers through the Reserve and Imperial Banks; (iii) transfers through the Government treasuries; (iv) transfers of rupees by rail or road; and (v) remittances through the Post Office. See *Report on Currency and Finance* (1946-7), Statement xxxv, for internal remittance statistics.

[4] See ch. viii above.

fundamental reason for the high rate is the scarcity of capital, which is the direct result of the great poverty of the people. The income of the great majority of the people is so small that any saving is scarcely possible for them. Another reason is that a considerable amount of potential capital takes the form of hoards, which lie idle and sterile in the absence of adequate banking facilities to attract them into profitable investment. These defects pointed to the need for a central banking agency which could spread the available resources more evenly over the different parts of the country and the different seasons of the year. Now that the Reserve Bank has been established, it is expected that the supply of additional note currency against eligible commercial paper will be facilitated and the question of penal rates of interest will not arise provided that the scarcity of genuine commercial bills (paper) against which additional note currency can be issued can be overcome.

§27. **Lack of a bill market.**—A well-organized bill market is an indispensable adjunct of an efficient money market and is essential for the smooth working of the credit mechanism. It is also necessary for linking up the various credit agencies ultimately and effectively to the central bank of a country. The present situation in India in this respect is most unsatisfactory. Inadequate development of the bill market is a weakness of the Indian banking system, and prejudicially affects the supply of credit. For instance, one of the difficulties in the way of the Reserve Bank of India making advances to scheduled banks is that the latter do not hold a sufficient quantity of rediscountable assets. This is not due to a lack of knowledge regarding the utility of the trade bill or unwillingness to make use of it. *Hundis*, which are the analogue of the Western bill of exchange, have been in use in this country from the twelfth century onwards, if not earlier. The scarcity of bills, which is clearly brought out by the very small proportion of their assets devoted to the purchase of bills by banks in India, may be attributed to the following reasons.[1] (i) Banks in India have to maintain a stronger liquid position than in Western countries, and therefore, a relatively large portion of their assets is locked up in gilt-edged securities. (ii) Before the inauguration of the Reserve Bank of India in April 1935 banks were not inclined to discount their bills with the Imperial Bank of India, as this was considered to be a sign of weakness by the market. (iii) Joint-stock banks preferred taking loans from the Imperial Bank on Government securities to offering bills for rediscounting because the latter was itself a competing commercial bank and no bank would like to give away the secrets of its bill portfolio to a rival bank. Moreover, since the Imperial Bank discounted only bills approved by itself at its discretion and did not lay down any standards in this respect, the joint-stock banks could not depend upon bills brought in by their customers. (iv) Another obstacle is the defective grounding of the bazaar *hundi*, which is not readily acceptable to banks, which are at present compelled to insist on the personal security of the endorsing shroff, if he happens to be on the bank's list of approved shroffs. It is not clear on the face of a bazaar *hundi* whether it is a pure finance bill or a genuine trade bill since it is not always accompanied by documents like sale contracts, invoices, documents of title, etc., whereby the bill could be supported and connected with a

[1] For a detailed discussion of this problem, see *C.B.R.*, chapter on The Banking System and the Money Market.

particular lot of goods or produce. Other difficulties are the baffling variety of languages in which the *hundis* are drawn, diversity of customs regarding days of grace, etc., widespread illiteracy of the masses, etc. (v) Another factor is the system of cash credits which is greatly in vogue in inland trade finance in India. However, the use of bills may be expected to be more popular, provided the banks take the initiative in the matter.

§28. **Measures to promote a bill market.**—The Central Banking Enquiry Committee have suggested various measures for the development of a bill market in India. (*C.B.R.*, 593.) (i) The Reserve Bank of India should be prepared to buy or rediscount at its published rate—which should be the minimum rate—first-class trade bills and promissory notes arising out of bonâ fide commercial transactions and should at its discretion charge higher rates for demand loans against authorized securities. The joint-stock banks need not look upon the Reserve Bank as their rival and may be expected to avail themselves fully of the facilities of rediscounting commercial paper offered by it. The Reserve Bank is authorized to discount eligible commercial paper, although so far it has not met with much success in stimulating the development of a bill market for India. (ii) Discounting charges should be reduced and a clearing house for bills should be established in all provincial capitals in order to secure the charging of one commission only. (iii) Warehouses should be established in various parts of India as this would tend to replace the pure finance (or accommodation) bills drawn by merchants and shroffs by documentary bills which would be readily discounted by banks. (iv) The stamp duty should be reduced. (v) The Post Offices should stock printed bill forms in English and Indian languages in parallel. The noting of dishonour and protest by recognized associations of banks, shroffs and merchants should be validated to save inconvenience and trouble to the owner of the instrument. The customs governing *hundis* should be standardized with a view to promoting their circulation. (vi) Banks should take the initiative in creating bank acceptances,[1] which would be more readily negotiable than ordinary trade bills. (vii) A discount market should be established by the adoption of bill-broking as an integral part of the indigenous bankers' business and by the formation of discount houses under the aegis of the Reserve Bank by these bankers and their wealthy depositors. (viii) The use of bills should be extended in respect of advances granted to the ryots for the growing of crops, in financing the marketing of crops, financing of village bankers by shroffs, financing of the movement of goods from the port town to the interior, and finally in the financing of the foreign trade of the country.

§29. **Utility of central banks.**—The International Financial Conference which met at Brussels in 1920 passed a resolution that 'in countries where there is no central bank of issue, one should be established'. Underlying this resolution is the idea that there is a close connexion between the maintenance of financial stability and a central banking organization. The advice embodied in this resolution has been widely followed in European countries and the United States,

[1] A banker's acceptance is a bill which the bank, under a prior arrangement with the purchaser of goods on credit, agrees to accept, the bill being drawn by the seller of goods.

till lately the home of decentralized banking.[1] In India by the force of circumstances the Government had come to take upon themselves important functions such as note-issue, management of cash balances, regulation of foreign exchange, etc., but it was felt that these functions were best performed by a central bank. Again, it was a great source of weakness that these functions should have been divorced from banking proper. This divorce led to the keeping of two distinct reserves, namely, Government's reserves and banker's reserves, with ill-defined relations between the two, and it made the monetary system highly inelastic. The absence of a central banking authority further led to a general lack of direction in the banking policy of the country. Though there was the 'multiple reserve' system in theory, that is to say, the various banks kept their own reserves, in practice these reserves were hardly adequate, and the danger was that in a crisis everyone would count upon everyone else. The bank failures of 1913-14 added to the strength of this argument. Other advantages expected from a central bank were a moderation of the wide fluctuations of the bank rate and mitigation of its normal high level through an enlargement and co-ordination of the banking resources of the country. The central bank would also provide adequate rediscount facilities, so that the other banks would be in a position easily to liquefy their assets, a facility which would increase their credit. A central bank would further take over from Government officials the responsibility for a variety of financial and semi-financial duties for the discharge of which they were ill equipped. The absence of expert advice and experience in India had resulted in the centre of power in financial matters being shifted to the India Office and the India Council, which, however, were not adequately in touch with conditions in India. The central bank would provide trained experience and advice on the spot, and it would also be useful as a buffer between the Secretary of State and public criticism. The manipulation of the discount rate so as to maintain currency stability is a function which falls peculiarly within the sphere of a central bank, and which is further calculated to help a fuller and more effective use of the Government balances for commercial and industrial purposes. A central bank would also extend banking facilities by helping the smaller banks and arranging for a continuous reduction of remittance charges from one part of the country to another, to the great benefit of the commercial community. The central bank would also be an instrument for the wider diffusion of sound and reliable banking practice. Lastly, international co-operation in currency and finance would be best attained if each country equipped itself with an efficient central bank.[2]

§30. **Formation of the Imperial Bank.**—The amalgamation of the three Presidency Banks seemed to be the only practicable basis for the creation of a central bank. The three Presidency Banks were taken over by the Imperial Bank as 'going concerns' with all their assets and liabilities. There was no provision fixing the location of the general head office. The Central Board was to meet at least once every year at every local head office. The capital basis of the bank was widened by providing for a capital and reserve of Rs. 15 crores as against Rs. 7 crores which was the capital of the three Presidency Banks put together.

[1] See Kisch and Elkin, *Central Banks*, p. 2.

[2] See Kisch and Elkin, op. cit., pp. 3-5.

The Imperial Bank is thus a private corporation but, until the establishment of the Reserve Bank of India in 1935, it was also a State Bank in the restricted sense that it was specially created by a specific Act of the Indian Legislature and was assisted, controlled and supervised by Government within certain limits. The chief difference between the Imperial Bank and the Banks of England and France was in regard to its very limited functions as a State Bank.

§31. **Constitution of the Imperial Bank.**—The control of the Imperial Bank was entrusted to a Central Board of Governors with local boards at Calcutta, Bombay and Madras. Two Managing Governors were appointed by the Governor-General-in-Council on the recommendation of the Central Board. The same authority nominated the Controller of Currency on the Central Board to be the guardian of the financial interests of the Government. The Governor-General-in-Council was entitled to issue instructions to the bank in respect of any matter which in his opinion vitally affected the financial policy or the safety of the Government balances. The duties of the Central Board were to deal with matters of general policy, to exercise general powers of control over the local boards, to determine the distribution of funds and the fixation of the bank rate (which is now called the advance rate), and to be responsible for the weekly publication of the bank's accounts. The local boards on the other hand dealt with the ordinary day-to-day business in their respective territories. For the current general (central) management there was a smaller working body consisting of three members of the Central Board, of whom one was the Controller of Currency. A novel feature was that the bank was allowed by the Act to establish a London office. It was not, however, permitted to deal directly with the public in foreign exchange, though it might transact business in London on behalf of the Indian Government, including the Secretary of State, public bodies, other banks and the old customers of the Presidency Banks.

§32. **Functions of the Imperial Bank.**—The Act of 1920 followed the old Presidency Banks Act of 1876 in defining absolutely the class of business in which the bank might engage, though the old restrictions were modified in some minor points, especially in regard to certain limited powers of access to the London money market and dealing in foreign exchange. The functions allowed to the bank were: (i) investments in certain specified securities of the Government of India and United Kingdom, Port Trust Bonds, certain Municipal Corporation Bonds and those of State-aided railways and of District Boards; (ii) advancing money against any of the above securities; (iii) advancing money against accepted bills of exchange and promissory notes, against goods or documents of title thereto deposited with or assigned to the bank; (iv) drawing, accepting, discounting and selling bills of exchange and other negotiable securities payable in India or Ceylon; and, subject to the direction of the Governor-General-in-Council, the discounting, buying and selling of bills of exchange payable outside India for, from or to such banks as might be approved. The bank was allowed to draw bills of exchange and grant letters of credit for the use of parties whose estates were being administered by the bank and also for private constituents or customers for bona fide personal needs; (v) borrowing funds in India and receiving deposits, receiving securities for safe custody and collecting interest thereupon, buying and selling gold and

silver, etc.; (vi) the London office was allowed to borrow money in England for the purpose of the bank's business upon the security of the bank's assets, but was not to open cash credits, keep cash accounts or receive deposits in London except from the former customers of the Presidency Banks.

§33. **Functions as a public institution.**—The functions of the Imperial Bank as a Government bank were as follows:

(i) The bank undertook all the general banking business of the Indian Government, and accepted payments and made disbursements for the Government. It held all the treasury balances at headquarters and at its branches. (This involved the abolition of the Reserve Treasury System.) (ii) The bank managed the public debt in return for a specified remuneration. (iii) The bank was required to undertake to open 100 new branches, of which the Government of India might determine the location of one in four. (iv) The bank was expected to give the public every facility for the transfer of money between its branches at reasonable rates approved by the Controller of Currency. The Government were to cease remittance of funds for the public between any two places where the Imperial Bank carried on business. (v) The London office of the bank, which was started in January 1921, took over a portion of the business of the Government of India which was previously in the hands of the Bank of England, for example, the current account of the High Commissioner for India.

§34. **Points of criticism against the Imperial Bank.**—The Imperial Bank as constituted in 1921 was made the target of much adverse criticism. It was a private concern and especially open to suspicion on account of the strong representation of European interests on it which might limit the utility of the bank to Indian commercial and industrial interests. The Imperial Bank had merely perpetuated the old management, the old policies and the old traditions of the Presidency Banks. English management might be unsympathetic and unable to understand the needs of Indian merchants and industrialists. The agents at mofussil branches, being mostly non-Indians, might fail to understand the local needs of the people and no effort be made to cultivate intimate and friendly relations with shroffs. The bulk of the deposits collected by the branches of the bank were not invested locally but sent to headquarters. The Imperial Bank was further subjected to the criticism which had been raised against European-managed concerns in general, namely that they did not provide for the training of Indians.[1] The Imperial Bank was also charged with discriminating against Indian firms and Indian institutions and with showing undue partiality to European firms and European institutions. The high dividends declared by the bank squared ill with the primary object for which the bank was constituted, namely the promotion of national welfare. There was no arrangement for the division of profits between the bank and the State. The control of the State over the bank under the Act of 1920 was not as effective as it should have been, as the Controller of Currency was expected to interfere only when Government interests were at stake. The branch banking policy of the bank was not very successful. Branches were sometimes established at places where there were already sufficient banking facilities, and this exposed existing banks to unfair competition at the hands of the Imperial Bank, which had special

[1] See vol. I, ch. xiii.

privileges and large command of Government funds, especially before the establishment of the Reserve Bank. Another group of criticisms was on the score of the excessively limited functions assigned to the bank and the consequent impairment of its utility. The bank had little real resemblance to the central banks of Europe in relation to the banking and currency functions it performed for the Government. Only the cash balances of the Government and duties of a general banking nature were handed over to it. The paper currency, the gold standard reserve and the remittances to England to meet the Home Charges were still managed by the Government. Not having the power of note-issue, the Imperial Bank could not effectively control the money market through the bank rate, as do other great central banks.

The monopoly of the exchange banks and the Government in the field of foreign exchange under the Act of 1920 was left practically intact. The fact that the exchange banks had prospered so well shows that the risky character of the business had been greatly exaggerated. Another restriction imposed on the Imperial Bank was that it could not borrow without security or accept deposits outside India. This was no more than a concession to the jealousy of the exchange banks, which also explained the exclusion of the bank from foreign exchange business. Borrowing and receiving deposits abroad sometimes might be necessary to ease the situation in the Indian money market. Lastly, the Imperial Bank, though it was intended to be a co-ordinating agency, was far from being a bankers' bank in the strict sense of the term. The other banks did keep their reserves with it, but only to a very limited extent. The result was that the Indian money market remained practically as inorganic as it was before the Imperial Bank was brought into existence.

§35. **The Imperial Bank of India (Amendment) Act, 1934.**—It was all along taken for granted that when the Reserve Bank should be established as the central bank of the country, it would be necessary to alter the constitution of the Imperial Bank with a view to freeing it from the restrictions imposed upon it on account of its hybrid nature and modifying the control of the Government over its operations. When therefore the Reserve Bank Bill was passed in 1934, the Imperial Bank of India Amendment Bill was also passed at the same time as the Imperial Bank of India Act (III of 1934).[1] The following were the main changes made by the amending Act:

(i) *Changes in the constitution of the bank.*—The Central Board was to consist of the following directors: (*a*) Presidents and Vice-Presidents of the Local Boards established by the Act; (*b*) one person elected from among themselves by the members of each Local Board established by the Act; (*c*) a Managing Director to be appointed by the Central Board for five years, who may be continued by the Board for further periods not exceeding five years; (*d*) such number of persons not exceeding two and not being officers of the Government as may be nominated by the Governor-General-in-Council; (*e*) a Deputy Managing Director to be appointed by the Central Board; (*f*) Secretaries of the Local Boards; (*g*) such number of persons to represent any new Local Board established under the Act

[1] See §36 below for the decision of the Government not to convert the Imperial Bank into a central bank.

as the Central Board may prescribe. The Directors specified in (*e*) and (*f*) were not entitled to vote at the meetings of the Central Board. The Deputy Managing Director was entitled to vote in the absence of the Managing Director. The Governor-General-in-Council was to nominate an officer of the Government to attend meetings of the Central Board, who was not, however, entitled to vote. Under the new Act the Controller of Currency ceased to be an *ex-officio* member of the Board, and the number of persons nominated by the Governor-General was reduced to two. So also the Managing Director was to be directly appointed by the Board. Government control over the working of the bank was thus lessened. (ii) The Imperial Bank of India, which ceased to be banker to the Government (this position is now occupied by the Reserve Bank), was authorized to enter into an agreement with the Reserve Bank of India to conduct Government business as the sole agent of the Reserve Bank. (This is more fully explained in §41 below.) (iii) The old limitations imposed on the business of the London office of the bank were removed. The bank was enabled to establish branches or agencies in India and foreign countries. (iv) The Central Board was authorized to establish Local Boards without the previous sanction of the Governor-General-in-Council. Similarly the bank is authorized to increase its capital without such sanction. (v) *Removal of some of the restrictions on the business transacted by the bank.* The principal changes are as follows: The bank was authorized to buy bills of exchange payable out of India, to borrow money out of India and to transact foreign exchange business. The period of advances and loans (as also of bills discounted) relating to the financing of seasonal agricultural operations was extended from six to nine months. The bank was authorized to acquire and hold and generally deal with, any right, title or interest in any property moveable or immoveable, which might be the bank's security for any loan or advance or be connected with such security. The bank was further authorized to advance and lend money, and open cash credits on the security of shares of the Reserve Bank, debentures or other securities for money issued under the authority of a municipal board or committee, or with the sanction of the Governor-General-in-Council, on the debentures or other securities for money issued under the authority of a Ruling Prince or Chief, or on debentures of companies with limited liability subject to directions issued by the Central Board. The bank was empowered to make advances and to open cash credits against goods hypothecated to the bank as security for such advances, loans or credits, if so authorized by special directions of the Central Board. Some of the old restrictions [e.g. restrictions on land mortgage business, or on the period (with modifications already noticed) of the advances and loans, on the amount of the loans to individual borrowers, prohibition of loans on the security of the shares of the bank, etc.] still continued to operate. These were justified on the ground that the Imperial Bank had been given the privilege of being the sole agent of the Reserve Bank and in that capacity conducted the Government's treasury business, and held Government balances.

§36. **The Reserve Bank of India Act, 1934.**—The general case for a central bank has already been examined. Such a bank had been widely desired in India, not only on account of the improvement in banking and currency machinery which it promised, but also because 'the growing political consciousness of the country

has led to the search for all national emblems, amongst which a Central State bank is one'.[1]

The White Paper on the Indian Reforms, published early in 1933, made it a condition that a Reserve Bank, free from political influence, should be set up by Indian legislation before introducing responsibility at the Centre as regards finance. The proposal was once again scrutinized by the London Committee on Reserve Bank Legislation in July 1933. The London Committee submitted its Report in August 1933, and the Reserve Bank of India Bill, drafted in accordance with its recommendations, was introduced in the Legislature on 8 September 1933 and became law on 6 March 1934.

(i) It was decided that the bank should be a shareholders' bank. The original capital was Rs. 5 crores divided into shares of one hundred rupees each, fully paid up. Separate registers of shareholders were maintained at Bombay, Calcutta, Delhi, Madras and Rangoon. The nominal value of the shares originally assigned to the various registers was Rs. 140 lakhs to Bombay, 145 lakhs to Calcutta, 115 lakhs to Delhi, 70 lakhs to Madras and 30 lakhs to Rangoon. Owing to subsequent transfers the distribution of the shares was altered appreciably, and there was a marked tendency towards concentration and consequent sterilization of votes (especially in the case of the Bombay area), as shown by the fact that the total number of shareholders declined from 92,047 on 1 April 1935 to 56,057 on 30 June 1940. During the same period the average number of shares held by each shareholder increased from 5·4 to 8·9. The Reserve Bank of India Act was therefore amended in March 1940, so as to restrict the tendency of the bank's shares to become concentrated in fewer hands. Under this amendment no person can be registered as a shareholder in respect of any additional shares acquired after 26 March 1940 by him, whether in his own name or jointly, so as to bring the total value to more than Rs. 20,000.[2] Each shareholder has one vote for every five shares subject to a maximum of 10 votes. Shares of the value of Rs. 2,20,000 are held by the Government for disposal at par to the Directors to enable them to obtain the minimum share qualification.

(ii) *Offices, branches and agencies.*—In pursuance of its obligations under the Act, the bank established offices in Bombay, Calcutta, Delhi, Madras and Rangoon and a branch in London. It could establish branches[3] or agencies in any other place in India and, with the consent of the Governor-General-in-Council, elsewhere.

(iii) *Management.*—The general superintendence and direction of the bank was entrusted to a Central Board of Directors which consisted of 16 members as follows : (*a*) A Governor and two Deputy Governors to be appointed by the Governor-General-in-Council after considering the recommendations of the Central Board ; (*b*) four Directors to be nominated by the Governor-General-in-Council ; (*c*) eight Directors to be elected on behalf of the shareholders on

[1] P. Lovett, *The Mirror of Investment*, p. 19.

[2] *Annual Report of the Reserve Bank* (August, 1940), p. 9.

[3] Branches of the Banking Department were established at Cawnpore, Karachi and Lahore. The Issue Department opened branches at these three places and also at Bombay, Calcutta, Madras and Rangoon.

the various registers, two each for Bombay, Calcutta, Delhi and one each for Madras and Rangoon; (*d*) one Government official to be nominated by the Governor-General-in-Council. This official and the Deputy Governors were not entitled to vote. The purpose of employing the Governor-General-in-Council to nominate four Directors was to redress deficiencies, if any, regarding the representation of important elements in the economic life of the country, such as agricultural interests. A Local Board for each of the five areas consisted of (*a*) five members elected by shareholders; (*b*) not more than three nominated by the Central Board with a view to securing the representation of territorial or economic interests not already represented, particularly agricultural interests. The elected members of the Local Board were to elect from among themselves one or two persons, as the case might be, to be Directors representing the shareholders on the register for the area for which the Board was constituted. The Local Board was to advise the Central Board on such matters as were generally or specifically referred to it and was to perform such duties as the Central Board by regulations delegated to it. The Local Boards were thus mainly advisory in their nature. No Director and no member of a Local Board could also be a member of the Indian Legislature or of a local Legislature. No salaried Government official nor an employee of any bank nor a director of any bank other than a co-operative bank could be a Director or a member of a Local Board.

§37. **Business which the bank could transact.**—(i) The bank might accept deposits without interest, from the Government, local authorities, banks and any other person. This provision was intended to prevent the Reserve Bank from competing with other banks and was in accordance with central banking practice elsewhere; (ii) the purchase, sale and rediscount of bills of exchange and promissory notes, arising out of bona fide commercial transactions, bearing two or more good signatures, one of which must be that of a scheduled bank, and maturing within 90 days from the date of such purchase or rediscount, exclusive of days of grace. In the case of agricultural bills drawn or issued for financing seasonal agricultural operations or the marketing of crops, the period allowed was nine months, and one of the two signatures had to be that of a scheduled or a provincial co-operative bank. Bills maturing within 90 days after date of purchase, bearing the signature of a scheduled bank, might also be purchased, sold or rediscounted if issued or drawn for holding or trading in Government securities; (iii) purchase from and sale to scheduled banks of sterling in amounts of not less than the equivalent of one lakh of rupees; (iv) purchase, sale and rediscount of bills of exchange drawn in or on any place in the United Kingdom provided the business was transacted with scheduled banks. The bank might keep balances with banks in the United Kingdom; (v) it might make loans and advances to States in India, local authorities, scheduled banks, or provincial co-operative banks, repayable either on demand or on the expiry of fixed periods not exceeding 90 days, against trustee securities, gold or silver, eligible paper, promissory notes of scheduled or co-operative banks supported by documents of title to goods; (vi) it might make ways-and-means advances to the Governor-General-in-Council or Local Governments repayable within 90 days; (vii) purchase and sale of securities of the Government of India and the United Kingdom subject to certain maxima; (viii) the bank

might act as agent to the Secretary of State or the Governor-General-in-Council, or Local Governments, or local authorities in the matter of purchase and sale of gold or silver, management of public debt, etc.; (ix) it might also make agency agreements with central banks in other countries; (x) the bank was authorized to borrow money for a period not exceeding one month from scheduled banks or other central banks; (xi) it was authorized to issue bank-notes (see §40 below); (xii) the bank was authorized to purchase, sell and rediscount bills of exchange drawn on and payable in India in order to enable it to discount rupee import bills in the event of such bills coming into existence in the future, as contemplated by the Central Banking Enquiry Committee; (xiii) the bank was also authorized to conduct open-market operations, which are an integral part of central banking practice elsewhere. When, therefore, in the opinion of the Central Board it was necessary to regulate credit in the interests of Indian trade, commerce, industry and agriculture, the bank might purchase, sell, or discount eligible paper (bills of exchange and promissory notes) directly in the open market (without the signature of a scheduled or a co-operative bank) or it might make loans or advances, or purchase or sell sterling. The Committee of the Board or the Governor, to whom such authority could be delegated, was to exercise such authority only on special occasions and subject to prior consultation with the Central Board except in cases of special urgency. In every case the Central Board had to be informed about the action so taken.

§38. **Business which the bank could not transact.**—The bank was prohibited from (i) engaging in trade or having a direct interest in any commercial or industrial undertaking; (ii) from purchasing its own shares, or the shares of any other bank, or any company, or from granting loans on such security; (iii) from advancing money on immoveable property or from owning such property (except for its own business premises, etc.); (iv) from allowing interest on deposits; and (v) from drawing or accepting bills payable otherwise than on demand. These prohibitions followed central banking legislation elsewhere and were intended to ensure the highest degree of liquidity of the assets of the Reserve Bank.

§39. **Central banking functions.**—The bank has the obligation to transact Government business, viz. to receive moneys and to make payments, to carry out their exchange, remittance and other banking operations, including the management of public debt. These services are not to be rendered freely, but on terms embodied in agreements. The bank has the right to transact Government (Central and Provincial) business in India and is entitled to receive their cash balances for deposit free of interest (except where the bank has no branches or agencies). The bank must also be entrusted with the issue of new loans.

§40. **Issue of bank notes.**—The bank has the sole right of issuing bank notes. The Issue Department is separated from the Banking Department on the model of the Bank of England, although the Indian Act prescribes the proportional method of holding reserves and not the English method of a fixed amount of fiduciary issue. The assets and liabilities of the Issue Department are to be kept distinct from those of the Banking Department. This arrangement, while it has the merit of presenting the accounts in the simplest possible form and of inspiring greater confidence in the note issue, has the defect of not showing the bank's

liabilities as one comprehensive whole. Although Burma was separated from India with effect from 1 April 1937 the Reserve Bank continued to be responsible for the management of currency in Burma until the country became politically independent.

The assets of the Issue Department were to consist of not less than two-fifths of gold coin, gold bullion, or sterling securities, provided that the amount of gold was not less than Rs. 40 crores in value. Of the gold coin and gold bullion, not less than 17/20ths were to be held in British India. The remaining three-fifths of the assets might be held in rupee coin, Government of India rupee securities of any maturity, and such bills of exchange and promissory notes payable in British India as were eligible for purchase by the Bank, provided that the rupee securities did not exceed one-fourth of the total amount of the assets or Rs. 50 crores, whichever amount was greater, or with the previous consent of the Governor-General-in-Council, such amount *plus* a sum of Rs. 10 crores. Gold was to be valued at par, i.e. 8·47512 grains of fine gold per rupee, rupee coin at its face value, and securities at market rate. Sterling securities were defined as balances at the credit of the Issue Department of the Bank of England, bills of exchange drawn on and payable in the United Kingdom within 90 days, and Government securities of the United Kingdom maturing within five years. It was also laid down that on the date of the transfer of note issue to the bank by the Government of India, and of the transfer of the Gold Standard and Paper Currency Reserves, the gold coin and bullion and sterling securities were not to be less than one-half of the whole amount transferred and the amount of the rupee coin was not to exceed Rs. 50 crores, any surplus over this amount being held by the Government in a separate account. Arrangements were made by which the bank and the Government could keep the rupee coin held in the assets at Rs. 50 crores or one-sixth of the total assets, whichever was greater. As in the case of the Federal Reserve and other central banks of the world following the proportional reserve system, the bank was authorized, with the previous sanction of the Governor-General-in-Council, for periods not exceeding thirty days in the first instance, which might, with like sanction, be extended from time to time by periods not exceeding 15 days, to hold as assets gold coin, gold bullion or sterling of less than two-fifths of the total assets. The bank was required to pay a tax on the deficiency during the period of suspension of assets requirements, at bank rate with an addition of 1 per cent per annum when such holding exceeded 32½ per cent of the total assets, and of a further 1½ per cent in respect of every further decrease of 2½ per cent or part of such decrease, provided that the tax was not in any event payable at a rate less than 6 per cent per annum. The Bank was placed under the obligation to supply different forms of currency. Thus it was required to issue rupee coin on demand in exchange for bank notes and currency notes of the Government of India, and to issue currency notes or bank notes in exchange for coin which was legal tender. It was to convert notes of five rupees or upwards into notes of lower value or other coins which were legal tender in such quantities as in the opinion of the Bank were required for circulation. The Governor-General-in-Council was to supply such coins to the bank on demand. Thus in view of the special conditions in India, bank notes were allowed to retain the same unlimited convertibility into silver rupees which

was a privilege enjoyed by the former Government currency notes. (See, however, ch. ix, §32.)

§41. **Exchange obligations of the Reserve Bank.**—The system of selling Council Bills which was an integral part of the gold exchange standard was also used by the Secretary of State for India to draw funds for his expenses from India. In 1923-4, however, sales of Council Bills were partially replaced by purchases of sterling in India from banks and private financial houses willing to sell their sterling resources in London for rupees offered to them in India. In the next year this became the principal method of remittance to the Secretary of State, and in 1927 it came to be the sole method. The purchases of sterling by competitive public tender used to be conducted by Government through the Imperial Bank of India. But, with effect from 1 April 1935, the function of sterling purchases and the responsibility for remittances to the Secretary of State was transferred to the Reserve Bank of India. The 'ratio clauses' in the Reserve Bank Act imposing upon the bank the obligation to buy and sell sterling so as to maintain the stability of the rupee-sterling rate have already been discussed. (See ch. ix, §24.)

§42. **Scheduled banks.**[1]—Every bank carrying on the business of banking in British India included in the second schedule[2] (i.e. having a paid-up capital and reserves of not less than Rs. 5 lakhs) is required to maintain with the Reserve Bank a balance the amount of which shall not be less than 5 per cent of its demand liabilities and 2 per cent of its time liabilities in India at the close of business on any day. This provision follows in principle §19 of the Federal Reserve Act of the U.S.A. and is intended primarily to enable the Reserve Bank of India to centralize the banking reserves of the country so as to regulate and control the credit position in the country by controlling the total volume of bank money created by member banks. It also serves incidentally to make a partial provision for the liquidity and safety of the deposits of member banks, who are expected to keep in addition sufficient till money. Each scheduled bank must send a weekly return both to the Reserve Bank and the Governor-General-in-Council showing its demand and time liabilities in India, the total amount of Government of India and bank notes held in India, the amounts held in rupee coin and subsidiary coin, the amount of advances made and bills discounted in India, and the balances held at the Reserve Bank. This power of the Bank to call for information is intended to give it efficient control of the credit system. Such returns may also be called for from provincial co-operative banks which have transactions with the Reserve Bank, although they are not compelled to keep any portion of their cash with the Reserve Bank. The indigenous bankers, as previously pointed out, are not yet listed as scheduled bankers.

§43. **Non-scheduled banks.**—Besides scheduled banks there are operating in

[1] This and the following section should be read with §§12 and 15 *ante*.

[2] The advantages of contact with the central bank of the country are being increasingly recognized by joint-stock banks, and some of them increased their paid-up capital, apparently with the primary object of being included in the list of scheduled banks. This tendency was to a certain extent due to a desire to secure the exemptions given to scheduled banks from the operation of the debt legislation in various provinces. *Annual Report of the Reserve Bank of India* (1937), p. 14, (1939), pp. 25-6 and (1940), p. 26.

this country a large number of small banking and loan companies incorporated under the Indian Companies Act, especially in Bengal. The number of such companies on 31 December 1938 was estimated at approximately 1,421 concerns which might be considered to be non-scheduled banks. Among them only 236 had a paid-up capital of Rs. 50,000 each. Up to the beginning of 1938 the Reserve Bank was receiving weekly returns and balance sheets from the scheduled banks alone. With the coming into force of the banking provisions of the Companies Act, as amended in 1936, it seemed desirable that as a central bank the Reserve Bank should obtain information regarding non-scheduled banks also. For this purpose the Companies Act was suitably amended in 1938. Of these non-scheduled banks a large number claim that they are not really banks within the meaning of section 277F of the Companies Act (see §19) and are therefore free from the obligation to submit the cash reserve returns prescribed by that Act.

§44. **The Reserve Bank and the Imperial Bank.**—The Reserve Bank has entered into an agreement with the Imperial Bank of India, subject to the approval of the Governor-General-in-Council, for a period of fifteen years. It will remain in force thereafter until terminated after five years' notice on either side provided the Imperial Bank maintains a sound financial position. Under the agreement, the Imperial Bank is to be the sole agent of the Reserve Bank at all places in British India where there is a branch of the Imperial Bank of India in existence at the time the Reserve Bank Act came into operation and where there is no branch of the Banking Department of the Reserve Bank. The latter was to pay the Imperial Bank (subject to revision after ten years) a commission on the total of receipts and disbursements dealt with annually by the Imperial Bank on account of the Government. In consideration of the Imperial Bank of India maintaining the existing number of its branches, the Reserve Bank was to pay to the former annually for the first five years Rs. 9 lakhs, for the next five years Rs. 6 lakhs, and for the next five years Rs. 4 lakhs. The Imperial Bank was not to open any branch in substitution for a branch existing at the time this agreement came into force, without the approval of the Reserve Bank.

§45. **The Reserve Fund.**—A Reserve Fund has been created by the transfer to the bank of rupee securities of the value of Rs. 5 crores by the Governor-General-in-Council. The maintenance of an adequate Reserve Fund is essential for covering depreciation in the value of assets of the Reserve Bank and promoting general confidence in the solidity of the banking system. After the payment out of the net annual profits (after allowing for bad and doubtful debts, depreciation in assets, etc.) of a cumulative dividend at such rate—not exceeding 5 per cent per annum—on the share capital as the Governor-General-in-Council fixes at the time of the issue of shares, a portion of the surplus is to be allocated to the payment of an additional dividend on the scale set forth in the fourth schedule, subject to a maximum dividend of 6 per cent. The balance of the surplus profits is to be paid to the Governor-General-in-Council, provided that, if at any time the Reserve Fund is less than the share capital, not less than Rs. 50 lakhs, or the whole of the surplus if less than that amount, must be allocated to the Reserve Fund. This limitation of profits to shareholders is essential as the bank must not become a dividend-hunting concern. It is also fair that the surplus profits should go to the

State since they represent largely the profit of the Paper Currency and the old Gold Standard Reserves.

§46. **The bank rate and weekly return.**—The Reserve Bank is required to publish from time to time the *standard rate* at which it is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under this Act. The bank has thus discretion to discount agricultural bills at concessional rates below the rate for discounting or rediscounting commercial paper. It should be noted that, unlike this provision of the Act, the practice of the Bank of England is to fix the minimum rate at which it will discount bills of exchange for others than its customers. It is generally fixed above the open market rate.[1]

The bank is required to submit to Government the annual account and a weekly return of the account of the Issue and Banking Departments in the prescribed form (Fifth Schedule) to be published in the *Gazette of India*. The weekly statement of the central bank in each country is regarded as the key to the condition of the money market.

§47. **Agricultural Credit Department.**—The bank was required to create a special Agricultural Credit Department, the functions of which are (i) to maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Governor-General-in-Council, Local Governments, provincial co-operative banks, and other banking organizations, and (ii) to co-ordinate the operations of the bank in connexion with agricultural credit and its relations with provincial co-operative banks and any other bank or organizations engaged in the business of agricultural credit. It is hardly possible to exaggerate the need for such an organization in an essentially agricultural country like India. This provision follows in principle a similar provision in the Commonwealth Bank of Australia Act. The main difference, however, is that the functions of the Agricultural Credit Department are of a purely advisory character as contrasted with those of the Rural Credit Department of the Commonwealth Bank of Australia, which has separate funds of its own, partly contributed by the Treasury and partly by the bank.

Mr M. L. Darling was deputed to investigate into the working and present state of the co-operative banks and credit societies, and the part which indigenous bankers play in the rural economy of the country. His Report together with a note containing proposals for the constitution of the Agricultural Credit Department were received by the Reserve Bank about the end of June 1935. The authorities of the bank, after examining and considering the proposals, decided to request the Local Governments through the Government of India to collect and furnish to the bank further particulars about co-operative banks, credit societies, and other agencies—e.g. indigenous bankers and money-lenders—engaged in the business of agricultural credit. Since a long time would be required to obtain detailed information as indicated above, the bank submitted to the Government of India, in December 1936, a preliminary Report on agricultural credit with a view to enabling the various parties concerned to proceed to a realistic examination of the question without further delay. This was followed by the Statutory Report at the end of 1937 which indicates the various directions in which improvements

[1] See W. F. Spalding, *The London Money Market*, pp.89-90.

might be made to enable the existing credit agencies, more particularly the co-operative agency, to be of greater use to the agriculturist and the manner in which the Reserve Bank can render assistance.[1] As pointed out by the Reserve Bank, it was not to be expected that the bank would be able to put forward a final scheme within the short initial period of three years, and it is giving continuous attention to these important problems.

§48. **The Reserve Bank of India in action.**—The Reserve Bank of India was officially inaugurated on 1 April 1935 and opened its offices at Bombay, Calcutta, Delhi, Madras and Rangoon. Later, arrangements were made for starting a London branch as provided for by the Act.

The actual working of the Reserve Bank of India justifies the claim that it inaugurated a new era of financial stability, banking reform and extension and re-orientation of the money market. It has helped in the orderly flotation of loans for Central and Provincial Governments at very low rates, in the making of remittances to the Secretary of State, in the sale of Treasury Bills and in maintaining the stability of the rupee. It gave valuable advice regarding the incorporation of new provisions relating to banking companies in the Indian Companies Act and in 1939 put forward useful proposals for the enactment of a Bank Act in India. It has offered valuable and cheap inland remittance facilities and helped to lower money rates. It has also given an indirect stimulus to the extension of banking facilities in the country.

It has established useful contacts not only with the scheduled banks, which are officially member banks, but also with a large number of small non-scheduled banks. As the monetary and credit authority, it has skilfully steered clear of many difficulties during the recent war and has thereby contributed to the stability of the money market. ' It is evident that the Reserve Bank is playing a great and effective part in the elimination of seasonal extremes in rates which cannot but have far-reaching consequences on the Indian economy of the future.'[3] It has also done useful work in connexion with the study of agricultural credit and the co-operative movement and has made many valuable suggestions for overcoming the various defects in the structure of rural credit.

It has not, however, so far fulfilled the principal anticipation, namely the development of a bill market in India, as shown by its paltry rediscounting of bills for scheduled and provincial co-operative banks. We must also state here that the Reserve Bank has not, so far, succeeded in linking up the indigenous bankers with itself, effectively stimulating the progress of the bill market, or unifying the two main parts of the Indian money market.

§49. **The Reserve Bank of India (Transfer to Public Ownership) Act 1948.**—This Act was passed to give effect to the Government's decision to turn the bank into a state-owned institution so that its activities might be controlled more effectively in the public interest and in order to ensure more co-ordination between the monetary, economic and financial policies. The Act came into force on 1 January

[1] This question has been more fully discussed in vol. I, ch. x.

[2] See *Annual Report of the Reserve Bank* (1937), also *Preliminary* and *Statutory Reports* issued by the Agricultural Credit Department of the Reserve Bank (1936 and 1937).

[3] Muranjan, *Modern Banking in India*, 1st ed., p. 285.

1949, when all shares in the capital of the bank were deemed to be transferred to the Central Government.

Compensation was to be paid to shareholders at the rate of Rs. 118-10-0 per share of Rs. 100 paid-up, partly in the form of promissory notes bearing interest at 3 per cent per annum and partly in cash. (The rate of compensation was based on the average monthly market quotations of the shares during the period March 1947 to February 1948.)

The power of general superintendence and direction vests with the Central Board, consisting of a Governor, two Deputy Governors and ten directors, all nominated by the Government, instead of twelve directors—eight elected and four nominated—which was the old arrangement.

§50. **Indian banking from 1939 onwards.**—Immediately on the outbreak of World War II, as well as on the beginning of hostilities by Japan in December 1941, banks in India were called upon to meet hurried withdrawals induced by panic, but the deposits soon began to return as the public realized the futility of panic and adjusted themselves to war conditions.[1] On the whole, the Indian banking system stood the first shock of the war well. Thereafter, owing to rapid expansion in advances to meet the increased demand for finance from the commodity markets, the stock exchange and the silver market as a result of the war and the higher prices prevailing, deposits showed an almost continuous increase.[2] An enormous growth of deposits has been the most noticeable feature of war-time banking in India. In August 1939, the deposit liabilities of the Scheduled Banks were Rs. 249.45 crores. But at the end of July 1944 they had risen to Rs. 759.29 crores. This phenomenon is due to the intimate connexion between banking and public finance and the inevitable expansion of currency which war brings about and which provides the basis for a larger superstructure of bank credit. The connexion between bank deposits and note issue is brought out in the following table :

	Rs. crores	
	Notes issued	Deposits
August 1939	216·78	249·45
March 1940	252·21	259·26
March 1941	269·25	284·64
October 1941	307·39	332·66
March 1942	421·06	322·16
March 1943	655·11	493·60
March 1944	891·78	688·65

Another noteworthy feature is the relatively greater increase in demand deposits (or liabilities) compared to time deposits. Between September 1939 and September 1944, demand liabilities rose from Rs. 133 crores to Rs. 578 crores whereas time liabilities increased from Rs. 102 crores only to Rs. 186 crores.

[1] The effects of the war on Post Office Savings Banks deposits and Cash Certificates have already been considered (see §22).

[2] See Banking Supplement of the *Eastern Economist*, 15 Sept. 1944.

This is due to a preference for greater liquidity on the part of the public, who were not investing but waiting for opportunities of profitable investment.

In view of the increased proportion of demand liabilities the banks maintained a more and more liquid position. While advances and bills, which are the most profitable items in the assets of banks, grew in volume, their percentage to total deposits declined from about 53 in 1939 to about 30 in 1944. This was due to the fact that during war-time opportunities for commercial investments are curtailed[1] and the banks invested their funds largely in war loans. Investment in Government securities was also prompted by the desire for greater liquidity referred to above. The volume of capital and reserves also grew but not in proportion to the immense increase in deposits. From about the middle of 1945, when the end of the war appeared to be in sight, the uneven ratio between demand and time liabilities began to correct itself. In 1946–7, not only did the time deposits grow comparatively more rapidly than the demand deposits as in the previous year, but they rose even when the demand deposits showed a tendency to fall, indicating the decline in the 'liquidity preference' of the depositors and the gradual return of the deposit structure towards the pre-war pattern.[2]

Another notable war-time development is the great increase in the number of banking offices, especially in 1943 and 1944. In the eighteen months ending June 1944, the increase was 688; in the quarter ending December 1943, it was 160; while in the first three months of 1944 there was an increase of 156. The rate slowed down subsequently and was 100 up to 15 September 1944. 'The explanation for this astonishing increase in this period lies in the fact that it was only in these two years that monetary expansion gathered its full momentum and banks felt the impetus to expand.'

Practically the entire increase is accounted for by the scheduled banks. 'The most spectacular and sensational increase is recorded by the Bharat Bank, which, starting to work in 1942, had 186 offices in March 1944 as against 101 in November 1943 and 6 in 1942.' While there has been an increase also in the average volume of resources per office owing to the greater increase in deposits, the greater part of these deposits has gone to the Imperial Bank and the larger scheduled banks, especially the 'Big Five', namely the Bank of India, the Allahabad Bank, the Central Bank of India, the Bank of Baroda and the Punjab National Bank. The smaller banks have opened new branches without a parallel increase of resources. This is a source of weakness. There is also a tendency for new offices being opened in the bigger towns to the neglect of the smaller ones. This leads to excessive competition and uneven development of banking in the country as a whole.

Unlike the war of 1914-18, World War II did not produce tight money conditions and a high bank rate. Rigorous control over interest rates has been an

[1] The main causes of these curtailed opportunities are (I) restrictions on imports and exports hampering movements of produce, (ii) accumulation of excess money with traders who are thus able to finance themselves without resort to banks, (iii) the system adopted by the Government of advancing fixed as well as working capital to industries for promoting war-production, and (iv) various measures taken by the Government to check speculation, such as Ordinances forbidding advances on the security of grain, bullion, etc.

[2] See *Report on Currency and Finance* (1946-7), p. 102.

essential feature of the new technique used for financing war expenditure, and its success has been abundantly proved by the way in which monetary authorities in both Great Britain and India have been able to maintain cheap money in spite of the vastly increased scale of public expenditure and expectation of colossal borrowing by the Government. Towards the end of August 1939, when the Bank of England's discount rate was raised from 2 to 4, it was feared that the monetary authorities in India might take similar action and lenders might adopt a cautious attitude. The result was a slight rise in interest rates. But with the lowering of the Bank of England rate to 2 per cent on 25 October 1939 and the expansion of currency by the Reserve Bank (see chs. viii and ix) against large purchases of sterling and of Treasury Bills, there has been no stringency in the money market and the bank rate has remained at 3 per cent.

The recent war like the war of 1914-18 has had the result of strengthening the cash position of banks in India. The increase in the clearing-house returns from Rs. 2002,85 lakhs in 1938-9 to Rs. 5617,17 lakhs in 1944-5 also indicates progress. (The figures for 1945-6 and 1946-7 are respectively Rs. 6542,62 lakhs and Rs. 7168,42 lakhs.)

While the adoption of exchange control and restrictions on exports and imports have somewhat adversely affected the business of exchange banks and there has been an occasional feeling of nervousness among depositors, we may conclude that the Indian banking system has shown great vitality and has been generally strengthened by the war.

§51. **Industrial finance.**—One of the great lacunae in the Indian economic structure is the absence of a properly organized system of industrial finance. The banks in Germany have played a very important role in satisfying the financial requirements of industries.[1] They provide the greater part of the initial capital for industries, which is subsequently placed among the investing public. In order to distribute the risk it is a very common plan for several banks to join together in a *Konsortium* and pledge themselves to accept a certain portion of the issue. This investment of banks in shares of industrial companies is, however, not a long-term investment as in the case of industrial banks proper, but is regarded as a safe investment of the banks' resources in first-class securities, which the banks expect to hold only for a short time. The banks themselves stand to benefit by these transactions since they are useful for acquiring business connexions and extending their influence. Industrial companies in Germany desirous of procuring new capital normally do so through banks with whom they are in permanent banking relations in the manner indicated above. It must, however, be remembered that the banks employ only a limited portion of their resources in industrial finance and that ordinary banking business constitutes their major activity.[2] The Central Banking Enquiry Committee declared themselves in favour of eliminating the Managing Agency system and depending for future development more on the

[1] See P. B. Whale, *Joint-Stock Banking in Germany*, pp. 36-66.

[2] For an interesting study of the methods of financing industries in Germany and other countries and their application to India the following books may be consulted: P. S. Lokanathan, *Industrial Organisation in India* (1935), pp. 242-50, N. Das, *Banking and Industrial Finance in India* (1936), ch. xi, and S. K. Basu, *Industrial Finance in India* (1939), chapters ii-iii.

establishment of direct friendly relations between industrial companies and commercial banks. They commended the adoption of the German system with suitable modifications, and suggested that a beginning in this direction might well be made by the Imperial Bank and the other commercial banks of established reputation. Besides much experience and wisdom, this class of business would require considerable owned capital and firm resistance against the temptation to speculate in the creation and sale of securities, and very few of the existing banks at present possess these qualifications.[1] In spite of these limitations of the situation as it exists in India, considerable financial assistance could be rendered to industries if the leading banks were to take a genuine and sympathetic interest in industries. With a view to creating an atmosphere of mutual confidence, while at the same time preventing entanglements incompatible with sound banking, the German model may to some extent be copied by banks in India. A useful link between banks and industries receiving their assistance could be established by appointing managing directors or managers of banks as directors of industrial concerns. The banks might also establish Local Advisory Committees to help them in assessing the financial position of their clients and to carry an assurance to the latter of fair and sympathetic treatment.

While valuable results may be expected from the co-operation of commercial banks as outlined above, the needs of industrial development are not likely to be adequately met by this method alone. The development of industries within their respective territories is one of the functions which is vested in the Provincial Governments. For a satisfactory discharge of this function it may be useful to establish Provincial Industrial Corporations, with branches, if necessary, and working with capital initially or permanently supplied by the Provincial Government concerned. These corporations should aim particularly at assisting enterprises which are likely to be of benefit to the public, add to the productive power of the province and provide employment for its people.[2]

The need has also been generally admitted for an All-India Industrial Corporation. There are certain industries of a national character so important that their development must be regarded as falling within the functions of the Central Government and not of the Provincial Governments. Further, the latter might themselves desire such an institution so as to establish direct connexion with the large spending departments of the Central Government as well as direct correlation for the industries as a whole with railway rates, customs, stores purchase and other policies of the Central Government. Legislation on the lines of the Madras State Aid to Industries Act should be enacted in other provinces to provide credit facilities to new and nascent modern or cottage industries. Any Government assistance in regard to provision of capital under such legislation should be given through the Provincial Industrial Corporation where one has been established.

[1] Dr P. S. Lokanathan (*Industrial Organisation in India*, pp. 251-2) points out the difficulties in the way of the adaptation of Indian commercial banking to the mixed banking of the Continental type.

[2] Dr Lokanathan points out the dangers of provincial banks being allowed to finance all kinds of industry and suggests that they should restrict themselves to the financing of public utility industries. Op. cit., p. 268.

§52. **The Industrial Financial Corporation Act, 1948.**—On 13 February 1948, the Dominion Parliament passed the Industrial Financial Corporation Act. Under this Act, the Industrial Finance Corporation was established on 1 July 1948 to provide medium- and long-term finance to public limited companies and co-operative societies registered in India, including the Acceding States, and engaged in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power. The general purpose of the Act is to make medium- and long-term credits more readily available than at present to industrial concerns. The share capital of the Corporation is Rs. 10 crores of which Rs. 5 crores is the paid-up capital. Of this Rs. 1 crore has been subscribed by the Central Government, Rs. 1 crore by the Reserve Bank, Rs. 3½ crores by scheduled banks, insurance companies, investment trusts, etc., and Rs. ½ crore by co-operative banks ; the balance is to be issued with the permission of the Central Government, as and when necessary. The Central Government has guaranteed both the return of the capital and payment of a minimum dividend of 2½ per cent, exclusive of income-tax. The Corporation is to be owned entirely by Government and institutions such as the Reserve Bank, Imperial Bank, scheduled banks, insurance companies, etc. Forty per cent of the shares would be held by Government and the Reserve Bank. The co-operative banks would hold ten per cent. The shareholding of the Government, the Reserve Bank (nationalized with effect from 1 January 1949) and the Imperial Bank (also likely to be nationalized in the near future) would be about 52 per cent of the total, which would ensure effective Government control. The Corporation must obey any directives issued by the Government on what they regard as questions of policy. All these controls are designed to prevent the Corporation from being exploited by private individuals and groups.

The management of the Corporation is entrusted to a Board of twelve members including the Managing Director: four are nominated by the Central Government, two by the Reserve Bank and the rest elected by the shareholders. The Corporation is authorized to borrow up to five times its paid-up capital and reserve fund. It may accept deposits up to Rs. 10 crores for periods of not less than five years. Finance is to be granted only to limited companies and co-operative societies provided they supply by their own efforts a reasonable proportion of the required funds and in the following ways: (i) by granting loans or subscribing to debentures of industrial concerns repayable within 25 years secured by sufficient pledge, hypothecation or mortgage of tangible assets; (ii) by underwriting the issue of stocks, shares and debentures ; (iii) by guaranteeing loans floated in the market repayable within 25 years.

The Corporation is prohibited from subscribing directly to the shares or stocks of companies. It is thus primarily a lender and not a partner in industry. Its policy is to finance the acquisition or extension of fixed assets, viz. land, buildings, plant and machinery, and thus to supplement rather than to compete with the activities of commercial banks. Applications for loans are examined with reference to (*a*) the financial position of the company as revealed by a study of balance sheets or inspection of accounts and assets, (*b*) technical soundness of the scheme and competence of management, and (*c*) importance

of the industry in the economy of the country. The Corporation is to be empowered to make loans either in Indian currency or a foreign currency as required to enable individual companies to obtain the necessary exchange for importing capital goods. It may also act as an intermediary in securing loans for industrial development in the country from such bodies as the International Bank, or the Export and Import Corporation of the United States.

The Corporation is made liable to income-tax.

§53. **The hoarding habit.**—The description of India as a bottomless sink of precious metals is well known. With reference to the supposed insatiable hunger of India for gold and silver, it has been picturesquely observed that 'the precious metals are taken out of the earth by one coloured race and put back into it by another coloured race'. It is likewise said that gold once passed into general consumption in India is permanently lost to the rest of the world. Europe had for a long time contemplated the steady absorption of the precious metals by India with amused wonderment not unmixed with satisfaction. If India had not swallowed up the gold and silver, the output of which had been enormously increased owing to the discoveries in recent times of new mines and improvements in the methods of extraction, a great derangement in the economic life of European countries would have been caused by a heavy rise in prices. But when in 1924-5, England and other countries of Europe were struggling to stabilize their currencies, India, entirely unmindful of the needs of Europe, was seen to add no less than £50 millions worth of gold to her hoards, European countries felt that their attempts at stabilization were being seriously hampered by India thus continuing to perform her age-long function as a sink with habitual thoroughness.[1]

The Indian hoards have been variously estimated. Probably the earliest estimate was that of H. D. Macleod, who was the first economist to get the Indian hoards on his brain. He tormented himself with the belief that the Indian hoards must be no less than £300 millions. Lord Curzon estimated them at Rs. 825 crores, while Arnold Wright, writing in the *Financial Review of Reviews*, December 1916, put them at £700 millions. Mr E. L. Price was inclined to accept an estimate of the American Trade Commissioner, namely £1,000 millions. Mr Francis Skrine thought that even this was very much an underestimate.[2] Sir James Grigg referred in 1938 to a tentative estimate given in the annual Report of the Bank for International Settlements for 1934-5, according to which the gold hoarded in India from 1493 to 1930 amounted to at least Rs. 1,454 crores. So that, with every fresh calculator, the calculations have proceeded in a regular *crescendo* movement.

In complaining of India's consumption of gold and silver, European writers have seemed to impute a double dose of original sin to the Indian people, and this apparent attempt 'to fasten on India an exceptional and invidious responsibility

[1] This contention lost much of its force owing to the export from India of over Rs. 351 crores worth of gold between September 1931 (when the rupee was linked to sterling at 1*s*. 6*d*.) and the end of January 1940. See *ante*, ch. ix, §22. While India was parting with her gold on such a large scale, extensive hoarding of the metal was taking place in the U.S.A. and several European countries, notably France.

[2] See Gubbay, op. cit., pp. 23 and 38.

for the consumption of gold'[1] provoked heated retorts. Some of these retorts were of the *tu quoque* variety. Not only India, it was pointed out, is addicted to the consumption of gold. The United States absorbed nearly £500,000,000 worth of gold from 1916 to 1923[2] and with more than two-thirds of the monetary gold concentrated in New York the passion for hoarding could scarcely be regarded as an Indian monopoly. A good deal of the gold in these centres was no doubt concentrated in the central banking reserves, and if a similar use of it was not possible in India, was it not the faulty currency system (the gold exchange standard), which was prevalent for a long time in India that was at least partly answerable for this? Those who bewailed the hoards of India generally forgot that part of the gold absorbed by India was used for industrial and domestic purposes, and, as Sir Stanley Reed remarked: 'Every country in the world uses gold and silver for industrial and domestic purposes, and it induces a sense of angry injustice to find that the Indian demand for the precious metals for precisely the same purposes is perverted into senseless hoarding.' Considering that India had a population amounting to about a fifth of the total population of the world, her annual (pre-1914) consumption of about 20 per cent of the world's output of gold could not be regarded as disproportionate or excessive,[3] and it is unfair to make her responsible in a special sense for any scarcity of the precious metals felt by other countries.[4]

And when once it was granted that the Indian demand for gold and silver was not abnormal, all things considered, this acquitted India of any particular responsibility for hindering the currency stabilization in other countries. If India's legitimate demand for the precious metals was embarrassing to other countries, the latter could devise currency systems less dependent on gold than they had been in the past.

All that has been said above aims at showing that the amount of hoards in India, properly so called, is generally grossly exaggerated. It would, however, be flying in the face of facts to deny the existence of hoards altogether. India has undoubtedly been a very large absorber of gold for non-currency uses, and her present stocks of the metal immobilized by being hoarded must be very considerable.

It need scarcely be pointed out that this is by no means a sign of wealth and prosperity. The hoards are, for the most part, held in millions of scattered, individually insignificant amounts and, moreover, being turned away from productive uses, they are more properly regarded as a cause of poverty than as an index of prosperity.

[1] Memorandum of Sir Stanley Reed to the Babington Smith Committee.

[2] Wadia and Joshi, *The Wealth of India*, pp. 388-9.

[3] It was sometimes urged in explanation and justification of the large imports of gold into India that they were after all due to India's favourable balance of trade, caused by the keen demand for her goods on the part of her foreign customers. This contention, however, appears to us to be of little value. It must be remembered that India was as anxious to sell, as foreign countries were anxious to buy, her goods, and if gold was sent to her in settlement of her trade balance it was because she preferred it to other commodities.

[4] As suggested above, the outcry latterly has been principally against the United States and France, and their policy of sterilizing enormous quantities of the world's annual supply of gold in the vaults of their central institutions, instead of using the gold for increasing the volume of currency and credit.

It is a moot point whether it is permissible to regard gold and silver ornaments as constituting part of the hoards to the extent of their full value, though it is usual to assume them as such. But there seems to be no reason why jewellery worn for purposes of personal adornment should be looked upon as hoarding any more than gold used, let us say, for stopping teeth. Both are forms of consumption of wealth rather than of hoarding. It is no doubt true that when people in India turn gold and silver into ornaments, they generally do so with the double object of personal adornment and holding wealth in store against a rainy day.[1] All the same it is necessary to distinguish between the two motives, and the precious metals can be regarded as hoards only in so far as they are intended to be stores of value.

Whether the Indian people are not inordinately fond of ornaments and jewellery and whether they do not invest a disproportionate amount of their earnings in them is a question which falls into the same category as a similar doleful inquiry which may be made, for example, with reference to the English workman, asking whether he is not more fond of beer than is good for him and whether he would not benefit more by spending his money in other ways. Both are questions relating to intelligent and well-ordered consumption. The spread of increased banking facilities is no more a cure for misguided expenditure on ornaments than it is a cure for misguided expenditure on drink (except in so far as ornaments are regarded as substitutes for banks). The Indian peasant indeed often spends money on ornaments for himself and for his wife, when perhaps he ought to spend the money on a mosquito net or on more and better food. The use of gold and silver is in some cases forced by custom and plays an important part in social ceremonies sanctioned by religion and tradition. These are regrettable facts, but to remedy them we must rely on the development of a better sense of values as well as on the softening of the rigour of social and religious custom through education and the progress of general enlightenment. But it must be clearly understood that this aspect of the matter is concerned with better or worse modes of consumption and expenditure and has nothing to do with hoarding proper.

When all the allowances suggested by the considerations advanced above are made, there still remains a certain residuum for which the proper name, it must be admitted, is hoarding. We have more than once referred to the faulty system of currency as a contributory case. But the principal cause is found in the numerous invasions to which India was subjected in the past and the continued misrule and insecurity of life and property from which she suffered. The habit that was contracted in times of insecurity has continued to survive in times of well-established peace and security. The present obstacles in the path of reform are the illiteracy of the population and the absence of adequate banking facilities. During 1926-7 and 1927-8, the average net imports of gold were only Rs. 1,875 lakhs as compared with an average of Rs. 2,815 lakhs for the five pre-war years (1909-14). In 1928-9 the net imports were Rs. 1,422 lakhs, which meant a drop of practically one-third when compared with the previous year. After 1931 there

[1] The Babington Smith Committee also call attention to the practical consideration that a woman, whether Hindu or Muslim, who possesses gold and silver ornaments, or coins converted into ornaments, is entitled to hold them as her personal property.

was actually, as already pointed out, a large net export of gold from India. This, together with the great success of some recent Government loans, indicates a certain welcome increase in the investment habit;[1] but only the fringe of the problem has, as yet, been touched, and for its complete solution we must look to widespread education and a much greater extension of banking facilities. The question of tempting the hoards into productive employment has latterly assumed a new importance. For though it may be true that the absence of a sound currency has encouraged the habit of hoarding, it is also true, on the other hand, that unless the hoards come out, it would be difficult for any currency system, however well devised, to function satisfactorily. For example, if hoarding persists, the control of currency and credit in the best possible way by the currency authority would present insuperable difficulties. The extension of banking, which is suggested as a cure for hoarding, is itself rendered difficult by hoarding. For how can banks carry on, if people will not put their money into them? But the other question is equally pertinent, namely, how can people put money into a bank, if there is no bank to put it into? It is thus a case of action and reaction, and the only remedy is to create as many credit institutions as possible and as great a variety of them as possible to suit the different needs and tastes of the people, leaving education and continuous propaganda to do the rest.

§54. **Fighting the hoarding habit.**—Various suggestions have been made for improving the present banking organization and fighting the hoarding habit. Some of them taken individually may appear trifling, but the combined effect of all of them is bound to be very considerable. We shall mention some of these suggestions:

(i) The Post Office is a ubiquitous agency and it should be utilized to its utmost capacity for promoting the investment habit. The work it is already doing in this field has been noticed above and some improvements have been suggested. Other suggestions are that (*a*) the interest on Post Office five-years' cash certificates might be allowed to accrue after the first and each subsequent quarter instead of the fourth as at present; (*b*) the limit of the total amount of cash certificates in the case of joint holders, banks and co-operative societies may be raised; (*c*) the Savings Bank pass books should be bilingual, one of the languages being English, and the other the principal language of the part of the province in which the head office of issue is situated; deposits by means of cheques should be permitted, as well as operating on the Savings Banks accounts by cheques; (*d*) increased facilities should be afforded by the Post Office to investors for the purchase and sale of Government securities and for their safe custody.

(ii) According to the Hilton-Young Commission's suggestion, gold certificates should be introduced as soon as feasible.

(iii) The Bihar and Orissa Banking Committee recommend special Women's Cash Certificates which would be called Stridhan Certificates, and which would be issued to women only at perhaps a rate slightly higher than the current rate of interest.[2]

[1] Government borrowing during the last few years has not been entirely successful, partly because of low interest rates and recently because of nervousness caused by the fear of wholesale nationalization of industries.

[2] Sir B. N. Mitra, speaking before a gathering of students at Bangalore, exhorted

(iv) The Government, as well as municipalities and local bodies, should make and accept payment by cheque as far as possible.

(v) National Savings Associations on the lines of those started in England should be formed for promoting thrift and for familiarizing the small saver with safe and profitable modes of investment.

§55. **Extension of banking facilities.**—Compared with other civilized countries, the number of banks in India is wholly inadequate to the real needs of the country. On 31 December 1937 there were only 587 head offices with 1,409[1] branches of banks, including agencies, throughout the whole of India excluding Burma. There were in 1928 only 339 towns in the whole of India served by either a bank or branch or an agency of a bank. This number of 339 against the total number of 2,300 towns strongly emphasizes the need for speeding up the expansion and progress of commercial banking in this country.[2]

The following table gives an interesting comparison of banking facilities in different countries, in the pre-depression period.

Banking Offices in India and in Foreign Countries on 31 *December* 1924[3]

Name of Country	No. of Banking Offices	No. of Banking Offices per Million of Population	No. of Banking Offices per 2,700 sq. miles
United Kingdom	11,976	285	362
United States	30,000	256	20
Japan	7,465	92	80
Canada	4,883	448	3
India	596	2	1

In spite of the considerable increase in the number of banking offices during the recent war (see §50 above), the contention holds that banking facilities still remain inadequate considering the size of the country, and the position of India as compared to the advanced countries mentioned above remains almost as unfavourable as before.

While it is clearly necessary to multiply banking institutions, it is also necessary to start diverse types of them. Joint-stock banking of the ordinary kind may not always be found to be suitable for Indian conditions. Other more suitable models which might be tried are furnished by the popular co-operative banks in Germany and Italy. These popular banks keep the shares as low as possible in order to encourage the small investor. Also the dividend is limited sometimes by

them to make their sisters understand that 'every ounce of precious metals they discarded would enable them to forge a link for the golden necklace of economic independence round the neck of their motherland'.

[1] These branches were distributed as follows: 7 offices and branches of the Banking Department of the Reserve Bank, 154 branches of the Imperial Bank, 88 of the Exchange Banks, and 1,160 of the Indian joint-stock banks. *Statistical Tables relating to Banks in India* (1937), par. 14.

[2] *C.B.R.* 569.

[3] Presidential Address of Principal M. L. Tannan, Indian Economic Conference, Calcutta, 1927.

law and sometimes by custom. Special terms are offered to poor investors as an encouragement to saving, and loans are advanced at low rates. Loans are also given on personal credit for objects approved of by the banks. Institutions of this kind are likely to flourish in India more than the usual kind of joint-stock banks.[1] It is now for the Reserve Bank of India wisely to guide banking progress in this country.

§56. **Institute of Bankers for India.**—As we have already seen, one of the reasons for the bank failures in 1913-14 was the generally prevalent ignorance of modern banking in India. The Indian Institute of Bankers, which was registered at Bombay under the Indian Companies Act on 20 April 1928, is calculated to remedy this defect in some measure. The main objects of the Institute are: (i) to support and protect the character, status and interests of persons engaged in or connected with the business of banking generally and especially in India, and consider all questions affecting them; (ii) to encourage the study of the theory of banking and for that purpose to institute a scheme of examinations and grant of certificates, scholarships and prizes; (iii) to spread information on banking and kindred subjects by means of lectures, discussions, periodicals, books, correspondence with public bodies or individuals, etc.; (iv) to collect and circulate statistics and other information relating to the subject of banking in India.[2]

The examinations held by the Institute have become well established. The Institute also conducts a journal. The lectures delivered under its auspices in Bombay and Calcutta have attracted large and appreciative audiences. The facilities for the study of banking, however, are at present confined to the Presidency towns. As funds permit, the Institute should endeavour to extend them up-country by means of correspondence courses, branch libraries, local lectures and colleges. The Central Banking Enquiry Committee recommend that the Institute should make arrangements for university lectures and courses of instruction at different centres in the subjects included in its curriculum.[3] It is hoped that the Institute may develop as a medium for co-ordinating banking practice in India.

1 See Gubbay, op. cit., pp. 29-32.

2 See *Memorandum and Articles of Association of the Indian Institute of Bankers*, 1928

3 *C.B.R.*, 761.

CHAPTER XII

FINANCE AND TAXATION

§1. **Introductory observations.**—Before the war of 1914-18 there was only one budget for the whole of India, and the Provincial Governments had no independent powers of taxation. The Central Government was the only taxing authority. After that war there had been almost complete separation of Provincial from Central finance, and the Indian financial system had been evolving on the lines of federal finance. A considerable change had also been going on for half a century or so in the relative position of the different sources of revenue. In the course of this period the land revenue had lost its old overshadowing importance and other sources of revenue had come into greater prominence.[1] The financial system of India had been recently coming more and more into line with other modern systems, as shown by the increasing variety of her taxes and the growing reliance on direct taxes like income-tax. Another great change had been with regard to the position of railways in Indian finance, and their evolution from blood-sucker to milch cow.[2] Opium, which not long ago used to make a brave show on the revenue side of the budget and was second in importance only to land revenue, has suffered almost a total eclipse as the result of India's great essay in philanthropic finance, and the small Budget revenue shown under this head since 1935 was derived from excise on opium sold for consumption in India.

CENTRAL HEADS OF REVENUE

§2. **History of the customs tariff.**—*(A)*—*Import Tariff in the period before the war of* 1914-18.—Until 1924, the Indian tariff had been on a scrupulously conscientious free trade basis. This involved very moderate import duties. Before the Mutiny there was an import duty of 5 per cent on finished goods and 3½ per cent on raw produce. Goods imported in non-British ships had to pay double the ordinary scale of duties till 1848. After that date the nationality of the shipping was ignored, though differential duties continued to be levied up to 1859 in accordance with the nationality of the goods, being double the ordinary rate on non-British goods. On account of the financial stringency which followed the Mutiny, this distinction was abolished and the general rate was raised to

[1] 'The land revenue which was the mainstay of the Government 40 years ago (1883-4), contributing 53·15 per cent of the whole receipts, now (1923-4) contributes only 20·75 per cent. On the other hand, customs has advanced from less than 3 per cent to over 24 per cent, and the income-tax from 1·32 per cent to 12·30 per cent. The share borne by excise (including salt duty) has fallen from 25·07 per cent to 21·67 per cent, partly owing to the reduction in the salt duty and partly no doubt to the drastic action taken in connexion with the intoxicants. The shares borne by stamp duties, including probate duties (about 10 per cent) and local taxation have been more consistent.'—*Report of the Indian Taxation Enquiry Committee*, par. 496. In calculating these percentages the Committee have not taken into account the total revenues of India, but only the total receipts under the heads of taxation, including therein also local taxation.

[2] The milch cow ran dry during the years of depression after 1929.

10 per cent. It was reduced to 7½ per cent in 1864 and 5 per cent in 1875. And eventually in 1882 all customs duties were abolished under pressure from the British Government inspired by the Manchester interest and in spite of the opposition of the then Viceroy, Lord Northbrook. Between 1882 and 1894 there were thus practically no import duties. But in 1894 owing to financial stringency caused by the falling rupee, a 5 per cent *ad valorem* general import duty was imposed. Cotton yarn and piece-goods, and certain other goods, however, were excluded from the operation of the tariff. Between 1899 and 1904, certain countervailing duties were imposed on bounty-fed sugar coming from Germany, Austria, Denmark and so forth. These were subsequently removed, the last duty of the kind being cancelled in 1912. Their only effect was to divert the import trade in sugar from Germany and Austria to other countries like Mauritius and Java where the system of bounties did not exist. The only other important changes before the last war in the import tariff were effected in 1910-11, when, to compensate for the loss of the revenue from opium and to meet additional expenditure, higher import duties were levied on silver bullion or coin, and petroleum. At the end of 1894 it was decided to levy a 5 per cent import duty on cotton fabrics and yarn, but to propitiate Manchester a duty of 5 per cent was levied on yarns of 20 counts and above produced in Indian mills. This excise on yarn did not give full satisfaction to Lancashire, and therefore, in 1896, the import duty on cotton piece-goods was lowered to 3½ per cent and an excise duty at the same rate was placed on all Indian mill-woven cloth ; cotton yarn, whether foreign or local, being altogether exempted from any duty.

This measure was bitterly resented in India. The excise duty seemed to injure India without benefiting Manchester. As was pointed out by Sir James Westland, 94 per cent of the cotton manufactures of India were outside the range of any competition with Manchester, being coarser qualities (24*s*. and under). Manchester had an absolute monopoly of the finer qualities of goods and the bulk of its trade consisted of piece-goods of counts about 30 or somewhat finer, and India could only produce goods of counts 26 or over in small quantities and under difficulties. Lastly, the reduction of the import duty from 5 to 3½ per cent would benefit the richer consumers of foreign cloth, while the home excise of 3½ per cent would affect the poor consumer adversely. The case against the excise duty appeared unanswerable. But, as was wittily remarked by an Indian member of the Imperial Legislative Council, so long as Lancashire sent sixty members to Westminster, the British Government would always have sixty good reasons for maintaining the duty, and thus the duty remained, in spite of continued opposition on the part of the people, till it was finally abandoned in 1926.

(*B*) *Export Tariff before the war of* 1914-18.—Until 1860, export duties were an integral feature of the early tariff policy and were levied generally at the rate of 3 per cent *ad valorem* on practically all exports. Though the duties were low and solely for revenue purposes, the principle of export duties was regarded as economically unsound and likely to do injury to the export trade by encouraging foreign competition. Accordingly a consistent policy of abolition was pursued from 1860 to 1880, so that at the latter date only the export duty on rice was allowed

to remain. In 1903, a trifling duty was levied at the request of the Indian tea industry on the export of tea.[1]

§3. **Customs tariff during the war (1914-18) and post-war period.**—Extensive changes in the customs tariff were introduced during the war and the post-war period which are briefly summarized below.

(*A*) *Import Duties.*—The general *ad valorem* duty was raised to 7½ per cent in 1916-17 (cotton piece-goods, however, were not raised to 7½ per cent till 1917-18); to 11 per cent in 1921-2 (including cotton piece-goods) ; and to 15 per cent in 1922-3 (cotton goods remaining at 11 per cent). Railway materials were taxed at 2½ per cent in 1916-17, and the tax was raised to 10 per cent in 1922-3. Iron and steel were raised from 1 per cent to 2½ per cent in 1916-17, and to 10 per cent in 1922-3. Sugar was increased from 5 to 10 per cent in 1916-17, and from 15 per cent to 25 per cent in 1922-3. Machinery and stores for cotton spinning and weaving were taxed at 2½ per cent in 1921-2, but exempted later on. A high specific duty on matches at 12 annas per gross boxes was imposed in 1921-2 instead of the 7½ per cent *ad valorem* duty. This duty was doubled in 1922-3. Luxury goods like motor cars, cinema films, watches, silk piece-goods, etc., were raised from 7½ per cent to 20 per cent in 1921-2 and 30 per cent in 1922-3. The duty on motor cars was reduced from 30 to 20 per cent and that on tyres from 30 to 15 per cent in 1927-8, in accordance with the recommendation of the Taxation Enquiry Committee, which stressed the importance of encouraging motor transport in India. The reduction in the duty left a wider margin for Provincial taxation on users of motor cars for the improvement and development of the Provincial systems of road communication. The tobacco duties were raised to 75 per cent *ad valorem* for cigars and cigarettes in 1922-3. In 1927-8 the duty on unmanufactured tobacco was raised from Re. 1 to Re. 1-8 per lb. A 5 per cent duty was imposed on foreign cotton yarn which had been free since 1893. We have already noticed the changes regarding foreign cotton yarn as also the raising of the revenue duty in 1930 on cotton piece-goods from 11 per cent to 15 per cent *ad valorem* and the imposition of an additional 5 per cent protective duty for three years on non-British goods.[2] A duty of one anna per gallon was put upon kerosene and petroleum, with a corresponding excise duty on the home products. The duty on imported liquors was increased in 1921-2 and again in 1922-3. In 1930, the silver duty of 4 annas per oz. was re-imposed (it had been abolished in 1920). The Finance act of 1930 introduced an all-round increase in the import duty on sugar. The acute economic depression and heavy deficits in the Central Budget led to further heavy and extensive increases in the import duties to provide additional financial resources. For example, the Finance Act of 1931 (March) introduced (i) increases in the substantive rates, in the case of duties on liquors, sugar, silver, and cinema films and (ii) additional impositions of the nature of surcharges ranging from 2½ per cent to 15 per cent. The Supplementary Finance Act of 1931 (November) effected further increases in the import duties on raw cotton, machinery, dyes, artificial silk yarn, silk piece-goods and electric bulbs, and levied a surcharge of ¼ of the existing rates on all customs imports including surcharges imposed by

[1] See vol. I, ch. vi, §7, 11(ii).

[2] See *ante*, ch. ii, §§9-14 for these and subsequent changes in the cotton textile duties.

the preceding Finance Act. The Indian Tariff (Ottawa Trade Agreement) Amendment Act of 1932 gave effect to the Ottawa Trade Agreement of July-August 1932. On the part of India this Agreement involved the grant to the United Kingdom of a 7½ per cent preference on certain classes of motor vehicles and a 10 per cent tariff preference on certain other classes of goods, there being a special arrangement for iron and steel goods. The Tariff Amendment Act made necessary changes in Schedule II to the Indian Tariff Act, 1894, with effect from 1 January 1933. The necessary preference was provided for either by raising the previous rate all round or partly by raising and partly by lowering it : the standard rate in no case went beyond 50 per cent *ad valorem*. The same Finance Act also reduced the import duty on silver by 2½ annas, i.e. to 5 as. The Finance Acts of 1934 and 1935 reduced the duty on silver to 5 as. and 2 as. per ounce respectively to discourage smuggling and to remove a possible obstacle to the revival of trade in the white metal. At the same time the excise duty on silver was reduced to correspond with the reduced import duty. But the Finance Act of 1937 increased as a revenue measure the import duty, and correspondingly also the excise duty on silver to 3 as. per ounce.[1] The import duty on raw cotton was enhanced from six pies to one anna per lb. by the Indian Finance Act of 1939.

The Indian Tariff (Third Amendment) Act (May 1939) gave effect to changes consequent on the provisions of the new Indo-British Trade Agreement which replaced the Ottawa Agreement. On the part of India the new Agreement involved the grant to the United Kingdom of a 7½ per cent tariff preference on certain classes of motor vehicles and a 10 per cent preference on certain classes of goods.[2] We have already[3] referred to the reduction in the import duties on British cotton piece-goods as part of the new Agreement. The Finance Act of 1941 increased the import duty leviable on artificial silk yarn and thread from 3 to 5 as. per lb. An all-round customs surcharge of 20 per cent was levied in 1942-3 on the existing import tariff except on raw cotton, petrol and salt and the petrol tax was also increased by 25 per cent. The surcharge on tobacco and spirits was also increased in 1944. In 1945 there was an increase in the standard rate of customs duty on unmanufactured tobacco and the rates on related items—cigars, cigarettes and manufactured tobacco. The new taxation measures for 1946-7 included an increase in the duty on imported betel-nuts to a standard rate of 5½ as. per pound (without surcharge) with a preference of 6 pies per pound for British colonies, the conversion of the *ad valorem* duty on unexposed cinematograph films into a specific duty of 6 pies per linear foot and of 4 annas per linear foot of exposed films, the amalgamation of the customs duty on cotton of 1 anna per pound under the Tariff Act and the duty of 1 anna per pound under the Cotton Fund Ordinance of 1942 into a consolidated duty of 2 annas per pound (without any surcharge) wholly leviable under the Indian Tariff Act, and the imposition of a specific duty (without surcharge) on imported gold bullion and coin at the rate of Rs. 25 per tola of 180 grains fine and the raising of the existing duty on silver from 3 annas 7⅕ pies (including surcharge) to 8 annas an ounce (without surcharge).

[1] Changes in the protective duties on sugar are reviewed in vol. I, ch. vi. See also § 4.

[2] For further particulars see ch. vii.

[3] See ch. ii, § 13 *ante*.

In 1948-9, the import duty on motor cars was raised from 45 to 50 per cent, with a preference of 7½ per cent in favour of the United Kingdom ; the duty on cigars, cigarettes and manufactured tobacco was slightly raised; the duty on unmanufactured tobacco was raised from 9 to 12 annas per lb. in some cases, and from 3 to 4 annas in others. There was an increase in the duty on matches from Rs. 1-12-0 to Rs. 2-8-0 per gross and an increase of 50 per cent in the duty on tyres (which was further increased next year).

In 1949-50, the import duty on motor spirit was raised from 12 annas to 15 annas per gallon (with a similar increase in excise duty), the duty on tyres used for motor vehicles was raised from 15 per cent *ad valorem* to 30 per cent *ad valorem* and the import duty on betel-nuts was raised from 5 annas a lb. to 7½ annas a lb. (imports from British colonies continuing to receive preference of 6 pies a lb.).

(*B*) *Export Duties.*—In 1916-17, two new export duties were levied on tea and jute. In the case of tea the export duty was fixed at Re. 1-8. This duty was abolished in 1927-8 but its abolition was accomplished by an increase in the income-tax assessment on the profits of the tea industry. In the case of jute, the export duty was fixed at Rs. 2-4 per bale of 400 lb., being approximately equivalent to an *ad valorem* duty of 5 per cent. Manufactured jute was charged at the rate of Rs. 10 per ton on sacking and Rs. 16 per ton on hessians. In 1917-18, the export duties on jutes were doubled. In October 1919, a 15 per cent *ad valorem* duty was levied on raw hides and skins as a measure of protection to the Indian tanning industry. The subsequent history of the duty and its reduction to 5 per cent has already been told.[1] The Finance Act of 1930 reduced the export duty on rice by one quarter, that is, from 3 annas to 2 annas 3 pies a maund, to meet the world fall in the price of rice and to put Burma on an equality with Siam—Burma's principal competitor in the trade—and as an act of justice and help to the Burmese cultivator.

The Finance Act of 1934 abolished the export duty on raw hides since the export trade in hides, especially with Germany, had been dwindling. The removal of the duty was expected to arrest this tendency. The Finance Act of the following year (1935) abolished the export duty on raw skins in order to assist the general revival of the export trade. Under the Agricultural Produce Cess Act of 1940 an export cess at the rate of ½ per cent *ad valorem* was levied on certain specified articles (such as bones, butter, wheat, seeds, skins, tobacco, raw wool, etc.) which were not already subject to an export duty or cess, with a view to placing the Imperial Council of Agricultural Research in a more secure financial position. In 1946 new export duties on tea and cotton were imposed and the duty on jute exports was enhanced. In 1947 the export duty on tea was increased from 2 as. to 4 as. per lb. In 1948-9 (i) the export duty on cloth was converted into an *ad valorem* duty of 25 per cent (handloom cloth being exempted) ; (ii) the duty on exports of yarn was withdrawn ; and (iii) an export duty of Rs. 80 per ton on oilseeds and Rs. 160 per ton on vegetable oils was levied (both duties were withdrawn in the following year). In 1949-50 a new duty of 15 per cent *ad valorem* was imposed on exports of cigars, cigarettes, and cheroots.

[1] *Ante*, ch. ii, §27.

The needs of finance during the war of 1914-18 and the post-war financial deficits called into existence a marked tendency of greater and greater reliance on customs duties. The customs revenue was adversely affected by World War II not only by the cessation of trade with enemy countries but also by the restrictions on imports and shortage of shipping. Since the war ended, the tendency towards continuous growth has re-established itself.

All these changes effected under the stress of financial stringency have changed the nature of the customs duties and the position occupied by them in the Indian fiscal system. A high general duty, wide breaches in the principle of uniformity, a curtailed free list, special taxes on articles of luxury, and lastly, the imposition of new export duties, are among the more important features of the new tariff as contrasted with the tariff before 1914.

Growth of Customs Revenue

Year	Crores of rupees	Year	Crores of rupees
1913-14	11·13	1933-4	45·72
1918-19	18·18	1935-6	46·73
1921-2	34·41	1936-7	40·61[1]
1922-3	41·35	1937-8	43·11
1924-5	45·75	1938-9	40·51
1926-7	47·38	1939-40	45·88
1928-9	49·28	1942-3	25·12
1929-30	51·28	1945-6	73·61
1930-1	46·81	1946-7	87·50
1931-2	46·44	1949-50	107·25
1932-3	51·96		

Till 1924 these changes in the tariff (except as regards the export duty on raw hides and skins) were governed by revenue considerations only. Some of the duties were, however, so high as to produce a definitely protective effect. We have noted how this strengthened the case for a properly thought-out system of protection in place of the haphazard protection which had thus come to be introduced. Since the passing of the Steel Protection Act of 1924, several frankly protectionist duties have been imposed. As a result of the Ottawa Trade Agreement (1932) and the Indo-British Trade Agreement (1939), the Indian tariff ceased to be a single-decker one and was characterized by tariff preferences for certain classes of goods imported from the United Kingdom, the Crown Colonies and Protectorates, thus differentiating between imports from different countries.

Analysis of the figures of customs revenue in the period 1913-14 to 1924-5 by the Taxation Enquiry Committee indicated a certain amount of shifting of the burden from the richer classes to the general population.[2] The 25 per cent duty on sugar seems to have been chiefly responsible for this, as it had the effect of raising the price of country as well as imported sugar, and thus of increasing the burden of taxation on the poorest classes who are large consumers of both kinds. Such must also have been the general effect of the increased duties on imports,

[1] Revenue attributable to Burma has been excluded. The customs revenue attributable to Burma in 1937-8, the first year of separation, was Rs. 4·26 crores.

[2] See *Report of the Taxation Enquiry Committee*, par. 145.

not only of sugar but also of cotton goods and silver (1930 and 1931), the increased excise on kerosene introduced by the Finance Act of 1930, the additional import duties and surcharges imposed by the Finance Acts of 1931 (March and November), and the excise duties on sugar and matches levied in 1934, 1940, and 1941.

According to a memorandum prepared in 1939 under the general direction of Dr Gregory, the then Economic Adviser to the Government of India, the weight of import duties pressed most heavily on goods of general consumption, less severely on luxury goods, and least on capital goods and raw materials.[1]

§4. **Central excise duties.**[2]—In the Budget session of the Assembly (March 1934) two new excise duties were levied with effect from 1 April 1934. The Sugar (Excise Duty) Act, 1934, imposed on (i) *khandsari* sugar and (ii) all other sugar, except palmyra sugar produced in a factory in British India, an excise duty of (i) 10 as. per cwt., and (ii) Re. 1-5 per cwt., respectively. This new excise duty was justified on the ground that it was needed to fill the gap in the revenue caused by the greatly reduced imports of sugar in consequence of the grant of protection supplemented by the surcharge imposed by the Supplementary Budget of 1931. The development of the sugar industry in recent years, it was argued, had been very rapid and there was a danger of overproduction owing to the unhealthy but uncertain stimulus given by the surcharges, which were in excess of the protection required by the home industry. The excise duty was intended to counterbalance the surcharge and to replace the loss of revenue. In order to meet the deficiency of customs revenue caused by a further drop in sugar and textile imports, the Indian Finance Act, 1937, raised the excise duty on *khandsari* sugar from 10 as. per cwt. to Re. 1-5 per cwt., and on sugar other than *khandsari* or palmyra, from Re. 1-5 per cwt. to Rs. 2 per cwt. This change involved a change in the import duty on sugar, which was fixed at the rate at which the excise was leviable on sugar other than *khandsari* or palmyra, *plus* Rs. 7-4 per cwt., the substantive protection to which the industry was entitled. The excise duty on *khandsari* sugar was reduced to Re.1 per cwt. in pursuance of Clause 10 of the Sugar (Excise) Order, 1934. The Indian Finance Act of 1940 raised the rate of the excise duty on sugar other than *khandsari* sugar from Rs. 2 to Rs. 3 per cwt., which automatically increased the import duty by the same amount.[3] The increase was effected as part of the programme of higher taxation in India's first war Budget (1940-1).

The Matches (Excise Duty) Act, 1934, imposed on matches made in British

[1] There appears to be a definite change in the nature of India's imports in recent years (say since 1926-7 onwards). The relative importance of goods of general consumption has diminished, imports of raw materials and capital goods have become more important, while luxuries have maintained a more or less stable position. See *The Burden of the Indian Tariff*, by T. E. Gregory and W. R. Natu (Studies in Indian Economics issued by the Economic Adviser), pp. 45-6.

[2] Central excise duties are at present levied on motor spirit, kerosene, sugar, matches, steel ingots, tyres, tobacco, vegetable products, betel-nut, coffee, tea and coal. The Central excise duties on kerosene, motor spirit and silver have already been noticed. The small coal cess is meant for assistance towards stowing under the Coal Mines Safety (Stowing) Act of 1939.

[3] The same Act raised the excise duty on motor spirit from 10 as. to 12 as. per gallon, and automatically increased the import duty by the same amount.

India and sold in boxes or booklets containing on an average not more than eight, an excise duty of (i) Re. 1 per gross of boxes or booklets if the average number was 40 or less, (ii) Re. 1-8 if the average number was more than 40 but less than 60 and (iii) Rs. 2 if the average number was more than 60. The Act also revised the customs duties on imported matches in such a manner as to comprise rates which maintained the existing measure of protection to the Indian industry over and above the equivalent of the new excise duty. This was justified by Sir George Schuster on the ground that it was needed so that the Government could recoup their losses caused by granting a half share in the jute export duty to the jute-growing provinces (Bengal, Assam and Bihar). It was maintained that Bengal, which had been suffering from successive budget deficits since 1930, badly needed help from the Central Government, and that this policy was also in accordance with the recommendation of the White Paper on Indian Constitutional Reforms (1933). The proceeds of the match excise, as also of a similar duty imposed by Indian States, were to be credited to a common fund, the Indian States being given a share in proportion to the consumption of matches in their territory on a population basis.

The excise duty on matches was doubled and a corresponding increase in the import duty was effected in March 1941, in connexion with the new taxation scheme embodied in the Budget for 1941-2 as part of a plan for meeting the heavy deficit arising from the increased expenditure caused by the war. At the same time a new excise duty of 10 per cent *ad valorem* was levied on pneumatic tyres and tubes manufactured in India. In 1944-5, the excise duty on tobacco was increased and betel-nuts, coffee and tea were brought under the Central Excise Tariff. In 1945-6, a further change was made in respect of tobacco. The highest class of flue-cured tobacco was subdivided into three and subjected to a duty of Rs. 7-8, Rs. 5, or Rs. 3-8 per lb., according as it was intended for use in manufacturing cigarettes containing more than 60 per cent, between 40 and 60 per cent, and between 20 and 40 per cent by weight of imported tobacco. In order to avoid double incidence some of the Provincial Governments reached an agreement with the Centre by which they withdrew the Provincial excise duty on tobacco in lieu of a share in the proceeds from the Centre's tobacco excise.

In 1947-8, the following changes in excise duties were introduced : (i) An excise duty on cigarettes amounting to about 25 per cent on ex-factory prices was imposed, (ii) the excise duty on betel-nuts was withdrawn and (iii) the excise duty on tea and coffee was reduced from 2 annas to 1 anna per lb. The changes in 1948-9 were (i) increase in the excise duty on sugar from Rs. 3 to Rs. 3-12-0 per cwt., and (ii) an excise duty of 6¼ per cent *ad valorem* on fine cloth and ¼ anna per yard on coarse and medium cloth (both confined to mill cloth) was imposed with effect from 1 January 1949. This was in addition to the duty of 25 per cent *ad valorem* on superfine cloth.

§5. **History of income-tax.**—Income-tax in India has a very long and chequered history. A general income-tax (from which agricultural incomes were not exempt) was first levied to meet the financial burdens of the Mutiny, for five years, at the end of which it ceased to operate in 1865. In 1867 another Act was passed imposing a licence-tax on professions and trades, excluding agriculture,

which continued to be levied till the end of 1872-3. No further taxation was imposed till 1877, when a licence-tax was levied on traders and artisans to meet a portion of the Famine Insurance Grant, and Acts were passed in 1878 for this purpose for the United Provinces, the Punjab, Madras, Bengal and Bombay. These Acts remained in force until 1886. The licence-tax of 1878 was, however, converted into a general income-tax by the Income-tax Act of 1886 applying to all India. Under this Act, all sources of non-agricultural income were taxed. On all annual incomes between Rs. 500 and Rs. 2,000 derived from salaries and interest on securities, a tax of 4 pies in the rupee was levied; while on incomes over Rs. 2,000 and on all profits of companies the tax was 5 pies, there being no further gradation of the tax. Similar incomes derived from other sources were taxed at practically the same rates, charities and religious endowments being exempted. In 1903, the favourable condition of the finances permitted exemption from the tax of incomes between 500 and 1,000 rupees.

The yield of the income-tax before 1914 was very small, being only about Rs. 3 crores, and the richer classes were allowed to escape too lightly. As a result of the increases effected during and since the war of 1914-18 (see §§ 6 and 7) the yield increased to over Rs. 22 crores in 1921-2. But after the rates were further raised in 1922 the country passed through a serious and prolonged industrial depression, and the yield of the tax decreased from Rs. 18·49 crores in 1923-4 to Rs. 15·42 crores in 1927-8. Later it slightly improved as a result of the substantial increases in the rates of income-tax and super-tax. But owing to economic depression, the improvement fell short of the estimates and was not commensurate with the increases in the rates and the levy of surcharges. The yield of the income tax (exclusive of the small share given to the Provinces) was Rs. 17·13 crores in 1933-4, 17·54 crores in 1934-5, 17·07 in 1935-6, and 15·34 in 1936-7. The separation of Burma from 1 April 1937 was responsible for a loss of Rs. 1·40 crores. The importance of the income-tax as a source of revenue has on the whole been increasing in every successive year since 1938-9. In 1938-9 the percentage of the total taxes on income to the total tax revenue was 23. Now it is more than 50.[1]

§6. Changes in income-tax from 1914 to 1939 summarized :—

1916.—Scale of progression introduced in the ordinary income-tax.

1917.—A super-tax in addition to the ordinary income-tax on a progressive scale was introduced.

1918.—The machinery of collection was amended and improved.

1919.—(i) The free minimum income was raised from Rs. 1,000 to Rs. 2,000 a year. (ii) Excess War-profits-tax was levied for a year on incomes in excess of Rs. 30,000, agricultural incomes, incomes of professional classes and public servants being exempted.[2]

1920.—Abolition of the Excess War-profits-tax. Amendment of the Super-tax Act in regard to profits of companies and registered firms.

[1] The highest percentages were reached in 1942-3 (64 per cent), 1943-4 (66·8 per cent) and 1944-5 (68·1 per cent).

[2] The Government claimed half of the excess profits, which were defined as the difference between the profits returned in 1918-19 and the average of the profits returned in the two pre-war years and the first two years of the war. Incomes below Rs. 30,000 were exempted from the tax.

1921.—The scale of progression both in the ordinary income-tax and the super-tax revised and raised.

1922, 1930, 1931 (March) and 1931 (November).—A further revision of both the kinds of taxes in an upward direction, including the levy of surcharges and the lowering of the free minimum income to Rs. 1,000 (November 1931).

1933, 1935 and 1936.—Reduction in the income-tax rates on smaller incomes and in the surcharges (1935-6) and the raising of the free minimum income to Rs. 2,000 (1936).

1939.—Adoption of the 'slab' system under the Income-tax (Amendment) Act of 1939, and abolition of the surcharges.

The main changes subsequent to 1939 have been noted in the next section.

§7. **Changes from 1939 onwards.**—The financial exigencies created by the war have been responsible for a number of changes in the Indian income-tax system. An Excess Profits Tax was introduced in March 1940 providing for a levy of 50 per cent on all abnormal war profits, above a taxable minimum of Rs. 30,000 earned since 1 September 1939, on the basis of a standard year which might be, at the assessee's option, any financial year between 1935-6 and 1939-40. Unlike during the war of 1914-18, the Excess Profits Tax was introduced in the early stage of the recent war. The tax was justified on the ground that it fell on those who benefited by the war. The Supplementary Finance Act of November 1940 provided for the levy of a 25 per cent surcharge for Central purposes only on all taxes on income including super-tax and corporation tax. The Finance Act of 1941 (March) raised the Excess Profits Tax from 50 to 66⅔ per cent (one-tenth to be repaid to the assessee) and increased the Central surcharges on income-tax and super-tax from 25 per cent to 33⅓ per cent. The super-tax was further increased to 50 per cent in the next year (1942-3). As a result of the budget proposals of 1943-4, a 66 per cent income-tax surcharge was applied uniformly over all levels of income. In the same year a levy was imposed on incomes between Rs. 1,501 and Rs. 2,000 at the rate of 6 pies in a rupee on excess of income over Rs. 750. In 1944 the surcharge was raised from 1 anna 8 pies (as in 1943) to 2 annas. Provision was made for advance payment of tax on income from which tax was not now deducted at source. An assessee had the option to pay tax quarterly either on the basis of his last assessed income or on the basis of his own estimate of current earnings. If, in the latter case, the assessee's own estimate fell short of 80 per cent of the tax determined on regular assessment, penal interest at 6 per cent on the difference was payable. On all sums paid in advance under the scheme, Government was to pay 2 per cent interest. In 1943 by Ordinance XVI it was prescribed that one-fifth of the Excess Profits Tax was to be deposited with the Government. In 1944 this was increased to 19/64 of the tax. The effect of this was to immobilize as deposits the whole of the excess profits remaining after E. P. T. had been paid on them and income-tax and super-tax had been paid on the balance. These advance payments and compulsory deposits were intended as anti-inflationary measures designed to stop the gap of rupee outgoings and rupee incomings. In regard to rates of income-tax the taxable minimum was raised from Rs. 1,500 to Rs. 2,000. On the slab of income from Rs. 10,000 to Rs. 15,000 the Central surcharge was increased from 16 pies to 18 pies in addition

to the basic rate of 24 pies; and on the balance above Rs. 15,000, the surcharge was increased from 20 to 24 pies, in addition to the basic 30 pies. The super-tax was increased by half an anna on the slabs of income between Rs. 35,000 and Rs. 2 lakhs. Corporation tax was increased to 3 annas in the rupee subject to a rebate of 1 anna on certain undistributed dividends of a company. A special provision was made for Life Insurance business, by which the combined rate of income-tax and super-tax was limited to 63 pies, which was the combined rate for Companies fixed by the 1942 Finance Act. Retrospective effect was given to this provision for 1943-4. A rebate of one anna in the rupee was allowed on the total income which was not distributed in dividends other than dividends payable at a fixed rate. In the case of life insurance business, the combined rate of income-tax and super-tax was limited to 63 pies in the rupee.

Excess Profits tax was collected at the rate of $66\frac{2}{3}$ per cent plus compulsory deposit of 19/64 of the tax.

In 1944-5, (i) The Central surcharge on income-tax was increased from 16 to 18 pies in addition to the basic rate of 24 pies on incomes from Rs. 10,000 to Rs. 15,000 and on the balance above Rs. 15,000, an increase in the surcharge from 20 to 24 pies in addition to the basic 30 pies.

(ii) The surcharge on super-tax on incomes between Rs. 35,000 and Rs. 2 lakhs was increased by six pies.

(iii) The Corporation tax was increased from 2 annas to 3 annas, a rebate of one anna in the rupee being allowed on so much of a company's total income as was not distributed in dividends other than dividends payable at a fixed rate.

(iv) The combined rate of income-tax and super-tax payable by life insurance businesses was limited to 63 pies with retrospective effect from 1943-4. The Indian Finance Act, 1945, provided for (*a*) an increase in surcharge on slabs of income above Rs. 15,000 and on incomes taxable at the maximum rate; and (*b*) an exemption of one-tenth of earned income subject to a maximum reduction in the amount of taxable income of Rs. 2,000.

In 1946-7 a number of concessions were granted to industry and to persons of moderate means. For instance, (i) complete abolition of the Excess Profits tax with effect from 1 April 1946, (ii) special initial depreciation allowances of 10 per cent on new buildings and 20 per cent on new plant and machinery as well as allowances for expenditure on scientific research for purposes of income-tax, (iii) a net reduction of $1\frac{3}{4}$ annas in the existing rate of super-tax and income-tax (payable by a Company) as a result of the lowering of super-tax by 2 annas and raising of income-tax by $\frac{1}{4}$ anna, (iv) exemption from income-tax for two years in the case of residential buildings and an initial depreciation allowance of 15 per cent for business premises, (v) reduction of total rate on life insurance companies from 5 annas 3 pies to 5 annas, (vi) reduction of rate from 15 pies to 12 pies on the second slab of income of Rs. 3,500 and from 2 annas 1 pie to 2 annas on the third slab of Rs. 5,000, (vii) the raising of the earned income allowance from one-tenth to one-fifth of the earned income (subject to a maximum of Rs. 4,000), and (viii) differential treatment in favour of earned income in the super-tax range

at the rate of 1 anna in the rupee between Rs. 25,000 and Rs. 2 lakhs and of ½ anna between Rs. 2 lakhs and Rs. 5 lakhs. On the other hand there was (i) an increase in the rate of income-tax on the balance of income above Rs. 15,000 from 4 annas 9 pies to 5 annas, (ii) increase in the number of slabs subject to super-tax resulting in higher imposts on the largest incomes and (iii) additional super-tax at steepening rates on dividends (other than dividends payable at a fixed rate) in excess of 5 per cent of the capital of a company (other than a private company) including reserves of 30 per cent of the total income, whichever was higher, this measure being intended to keep the distribution of dividends within reasonable limits and encourage the ploughing back of profits into industry. In 1947, while the minimum exemption limit was raised from Rs. 2,000 to Rs. 2,500, (i) a special income-tax of 25 per cent (later reduced to 16⅔ per cent) was levied on business profits exceeding Rs. 1 lakh, (ii) capital gains exceeding Rs. 5,000 (later raised to Rs. 15,000) made in recent years from the disposal of capital assets were subjected to a graduated tax, (iii) the scale of super-tax was changed so as to reach the maximum of 10½ annas in the rupee at Rs. 1·2 lakhs for unearned income and at Rs. 1·5 lakhs for earned income and (iv) the rate of Corporation tax was doubled to As. 2. In justification of the tax on business profits Mr Liaquat Ali Khan, the Finance Member in the Interim Government, stated that the complete abolition of the Excess Profits tax in the previous year had been premature, while the levy on capital gains was based on the United States model and would affect only incomes which might properly be described as unearned increment. The following were some of the measures of relief in income-tax which were adopted in 1948-9: (i) reduction of the Business Profits tax from 16⅔ per cent to 10 per cent and raising of the abatement to Rs. 2 lakhs or 6 per cent of the capital employed whichever was larger (against the existing Rs. 1 lakh or 6 per cent); (ii) the raising of the limit of income, at which the maximum rate of 10½ annas was to be applicable, to Rs. 3·5 lakhs for both earned and unearned incomes instead of Rs. 1·5 and Rs. 1·2 lakhs respectively, with rearrangement of the rate of tax within the slabs; (iii) reduction of the tax on undistributed profits of companies from 5 to 4 annas in order to encourage the ploughing back of profits into the business; (iv) income-tax on companies with an income of Rs. 25,000 and below was reduced to half the usual rates to encourage the growth of small companies; (v) the minimum amount assessed to income-tax was raised from Rs. 2,500 to Rs. 3,000.

In 1949-50, the Capital Gains tax was abolished and the tax on incomes up to Rs. 10,000 was reduced by a quarter of an anna, from one anna to nine pies, in the second slab. As regards super-tax, in respect of earned income the tax was reduced by an anna and a half on incomes above Rs. 1½ lakhs, bringing the tax including income-tax and super-tax together to 14 annas. For unearned incomes the reduction was 6 pies in the maximum rate of super-tax. The concession granted in 1948-9 to companies with an income of Rs. 25,000 and less was now given the form of a rebate of half the Corporation tax and was limited to public-controlled small companies which are not branches or subsidiaries of bigger companies. All corporations, whether Indian or non-Indian, were to be treated as companies. But an additional super-tax of one anna in the rupee was to be paid by those privately-controlled companies which did not distribute their profits in India.

On 10 June 1949 the Governor-General issued an Ordinance called the Taxation Laws Amendment Ordinance, which gave effect to the concession of depreciation at double the existing rates on new buildings, plant and machinery set up on or after 1 April 1948 and also exemption from income-tax of new industrial undertakings up to a limit of 6 per cent of the capital employed—concessions which had previously been decided upon by the Government of India in October, 1948. The Business Profits tax was continued with some changes for the year 1949-50. It was abolished in 1950-1 on the ground that owing to the greatly reduced level of profits it was bearing hardly on industrial concerns and that the receipts from it had been falling steadily. Among other changes introduced in 1950-1 were the following: (i) the maximum rate of income-tax was reduced from 5 to 4 annas; (ii) the exemption limit for an undivided family was raised from Rs. 5,000 to Rs. 6,000; (iii) for purposes of the super-tax the distinction between earned and unearned income was removed and both were taxed at the same uniform rate; (iv) the maximum super-tax was reduced to 8½ as. The maximum rate of personal taxation was thus brought to 12½ annas, i.e. 78 per cent.

§8. **Reform of income-tax.**—Sir Walter Layton, the Financial Assessor on the Simon Commission (1930), pointed out various defects in the then existing income-tax system in India and suggested certain reforms.

Some of the reforms (e.g. steepening of the progression of income-tax) suggested by him were given effect to in the Budget for 1931-2. In October 1935 the Government of India took steps to conduct a comprehensive review of the Indian income-tax system and administration by a committee consisting of two British experts and one of the senior Income-Tax Commissioners. A Bill to amend the Indian Income-tax Act on the lines recommended (1936) by the Committee was passed by the Central Legislature in 1939. It substitutes the 'slab' system under which progressive rates are applied to successive slices of income for the former 'step' system under which the tax was charged at the same rate on the whole income. It adjusts the categories of income-tax payers so as to mulct the wealthy minority more and while giving relief to the small man is calculated to produce a larger yield. It prescribes compulsory returns of income and seeks to tax the aggregate income of husband and wife. It aims at preventing tax evasion by people and firms who logically ought to be taxed, but under the law as it stood could manoeuvre their incomes or parts of them outside the range of the tax-collector's rake. A number of its provisions affected the joint-stock companies, especially in relation to the changed system of depreciation allowances. The Act did not provide for abatements of income-tax by way of family allowances. The main objection to granting such allowances was that they would apply to the vast majority of individual tax-payers in India and would therefore be very costly.

§9. **Taxation of agricultural incomes.**—Another aspect of the reform of the income-tax relates to the proposals to assess agricultural incomes to income-tax. Sir Walter Layton recommended that the exemption of agricultural incomes from income-tax should be removed by stages at specified dates.[1] The argument

[1] The Taxation Enquiry Committee point out that the inequality between the landholders of different classes is aggravated by the absence of an income-tax on agricultural

that land revenue is the counterpart of income-tax in other countries, and that to impose income-tax as well would be a form of double taxation, is not convincing, because land revenue cannot be increased in proportion to increased productivity even where there is temporary settlement, and not at all where there is permanent settlement. Frequent and substantial adjustments of land revenue assessments present serious political difficulties besides hitting the small holding equally with the large. An income-tax on agricultural incomes is not open to these objections. The present elaborate machinery for the maintenance of land records and for the administration and collection of land revenue could be effectively utilized for estimating agricultural profits. One of the advantages of the tax would be that, as a result of taking into account income from all sources—agricultural as well as non-agricultural—the non-agricultural incomes of people owning land would be subjected to a higher rate of income-tax. Incidentally, the change would check the tendency for savings accumulated in industry to be invested in land in order to escape taxation.

As the income from all sources would have to be considered for determining the rate of assessment, the machinery of collection and administration would have to be Central and the rate would have to be fixed by the Central Government. But the yield could appropriately be assigned to the province where it was collected. In their Dispatch on the Simon Commission Report, the Government of India argued that in spite of the theoretical objections to the exemption of agricultural incomes, it had the sanction of long tradition and that dealings in land had always been conducted on the assumption that it would remain. They also pointed out that most of the local Governments were definitely opposed to the removal of the exemption and regarded it as unlikely that this reform should be put into effect in the near future. The Government of India Act (1935) empowered individual provinces, if they so desired, to impose a tax on agricultural incomes originating in the province concerned. In 1939 the Assam Legislature passed by a narrow majority the Agricultural Income-tax Bill sponsored by the Government. Bengal, Bihar and Travancore followed, introducing a tax on agricultural incomes. Similar legislation is contemplated in other provinces.

§10. **Salt.**—The salt revenue was inherited by the British Government from its predecessors along with a large number of transit dues : these were abolished in 1843, and the salt duty was at the same time consolidated and raised. Before 1882 the rate of the duty varied from province to province. In that year it was made uniform at Rs. 2 per maund, but was raised to Rs. 2-8 in 1888 in the period of falling exchange. It continued at that level down to 1903, when easier finances permitted its being lowered to Rs. 2-4. It was further reduced to Re. 1-8 in 1905 and to Re. 1 in 1907, at which level it continued till 1916, when financial stringency caused by the war of 1914-18 led to an increase in the duty to Re. 1-4. In the budget of 1923, the Government's proposal to raise the duty to Rs. 2-8 was rejected by the Assembly but was carried through by certification by the Governor-General. In 1924, however, the Assembly exercised the option given to it by the Government in favour of reducing the salt tax to Re. 1-4 per maund as an alternative to

incomes or a death duty, which serves in the more advanced countries to introduce an element of progression in the land tax.

reductions in the Provincial Contributions. The duty was raised to Re. 1-9 with effect from 30 September 1931 by the Supplementary Finance Act of 1931 which imposed a surcharge of 25 per cent on the existing rate.[1] An unsuccessful attempt was made to reduce the basic salt duty of Re.1-4 to 12 annas (which would have meant a loss of Rs. 3½ crores) by the Congress party in the Assembly in the Budget Session of 1935. The same party sought without success the complete abolition of the salt duty during the Budget Session of March 1936. We have already indicated the different sources of salt in India and their relative importance (see vol. I, ch. ii, §36). About one-half of the indigenous salt is manufactured by Government and the remainder under licence and excise systems.

The salt duty was usually justified on the ground that it afforded the only means in a country like India of reaching the masses by direct taxation. The principal objection to the salt tax was that it is a tax on a necessary of life.[2] It was a regressive tax since it pressed more heavily on the poor than on the rich; for a comparatively larger proportion of their income is spent by the poor on salt than by the rich. It was however defended on the ground that it was an old tax, and that an old tax is no tax in the sense that from sheer habit people cease to think of it as a hardship. Moreover it was alleged that its incidence was so light that it could be regarded as negligible even in a poor country like India.[3] While, therefore, the abolition of the duty would scarcely be felt as a relief by the taxpayer, it would involve the sacrifice of a considerable source of revenue.[4] However, the agitation against the salt tax had been as old as agitation against the British Government and it was therefore a foregone conclusion that the abolition of the duty would be one of the first acts of a popular Government. The budget announcement of March 1947 that it was to end did not therefore cause any surprise.[5]

§11. **Opium.**—As already hinted above, opium was until recently a very considerable source of revenue, and the occasional windfalls from this head were at one time notorious. With regard to the administrative aspect of opium revenue, the method of production and sale under Government monopoly was adopted, in preference to heavy export duties, as being more satisfactory from the revenue point of view and as obviating the possibility of smuggling.

[1] See vol. I, ch. ii, §36 for the (Additional) Import Duty on salt.

[2] Critics of the salt tax were also fond of pointing out that successive reductions in the tax since 1903 had been followed by considerable increase in consumption suggesting that the tax had been kept at an unwisely high level. However, conclusive proof that the tax had caused any appreciable curtailment in consumption is not available. On the contrary the figures appear to show that *per capita* consumption has remained steady for the last 30 years and more in spite of changes in the rate of the tax.

[3] Assuming average consumption per head at half a seer per month, the tax worked out at 9 pies per head per month. See *Eastern Economist*, 7 March 1947, p. 442, Article 'End of Salt Duty'.

[4] Between 1941 and 1947 the yield from the salt tax had fluctuated between Rs. 8·34 crores and Rs.10·91 crores.

[5] However in an Ordinance published on 16 January 1948, the Pakistan Government announced a reimposition of the duty in Pakistan and used the familiar arguments in support of it, viz. (i) that all citizens ought to be made to contribute to the revenues of the State, (ii) that the salt tax yielded a substantial revenue at a small cost of collection and (iii) that its burden on the individual consumer was negligible.

The revenue from opium until the end of 1935 was derived from three main sources : (i) the monopoly profits of the sale of opium manufactured in Government factories and intended for export to foreign countries ; (ii) income from the export duty levied on the purchase of opium sent out from the Indian States of Rajputana and Central India ; and (iii) profits of monopoly in the form of licence fees or vendor's fees derived from the internal consumption of opium in British India. This revenue was credited to or shown under the revenue from excise, and that from the first two sources under opium proper.

In 1907, under pressure from Whitehall, the Government of India entered into an agreement with China, under which sales on Government account for export to China were stopped from 1914. It was said that in this manner British righteousness was satisfied at the cost of Indian revenues. It was also complained that China herself had failed to fulfil her part of the agreement and had been unable to decrease her own production of opium. At present, the revenue from opium is very much lower than formerly, being less than half a crore of rupees in 1941 as contrasted with the annual average of about Rs. 8 crores during the three years preceding 1913. It was announced by Lord Reading in February 1926 that the Government intended to abolish all exports of opium in future except for strictly medicinal purposes in accordance with the instructions issued by the League of Nations. The Government of India further agreed to stop all exports of opium before 1935, with the result that the revenue from exports of provision opium has ceased since the end of the year 1935. Now the receipts from opium are confined to opium sold for consumption in India, which is strictly regulated. Internal consumption is, however, still high according to the standard laid down by the League of Nations. Altogether opium as a source of income has faded into insignificance. In fact from 1943 to 1946 it was a burden on the general revenues.

PROVINCIAL HEADS OF REVENUE

§12. **Land revenue.**—We have already dealt with land revenue in chapter xii of vol. I. The total amount of land revenue collected in British India amounted to Rs. 31·89 crores in 1936-7, as compared with Rs. 35·27 crores in 1927-8. The drop was caused by the depression in the rural areas. The separation of Burma with effect from 1 April 1937 was responsible for a further decline in the land revenue, which amounted to Rs. 27·25 crores in 1939-40. The subsequent improvement due to reduced remissions has been more than wiped out owing to the separation of Pakistan.

§13. **Excise.**—Excise revenue is derived from the manufacture and sale of intoxicating liquors, hemp, drugs, opium and so on. It is levied in the form of a duty on manufacture, and fees for sale licences. The major portion of the revenue is derived from country liquors. The system followed in regard to country liquor excise is that of granting by contract the right of wholesale supply for a district and selling by auction the right of retail sale. Two large distilleries in Bombay were recently placed entirely under Government management, thus partly suppressing the contract distillery system. In 1861-2 the excise revenue was Rs. 1,78,61,570 and expenditure Rs. 13,53,470. In 1929-30 the revenue reached the high figure of Rs. 20,41,23,285 and the expenditure Rs. 2,19,18,391. Whether

this astounding increase of net revenue was to be looked upon as an index of growing drunkenness was a matter of controversy. The Government explained it as being mainly the result of higher rates of excise duties, and a stricter control, though it was also suggested that some of the increase was due to the expansion of population and the greater prosperity of certain classes. The excise revenue fell considerably in the first instance owing to the economic depression after 1930 and later owing to the introduction of partial prohibition in some provinces. The separation of Burma was also responsible for the loss of about a crore of revenue under excise. For example it yielded Rs. 15·37 crores in the year 1936-7 and Rs. 12·29 crores (exclusive of Burma) in 1939-40.

Public opinion in this country was seriously alarmed at what it regarded as an unmistakable sign of increase of drunkenness. Although there is a general agreement that energetic and courageous action is necessary for suppressing the evil of drink, there is no such agreement as regards the means to be adopted for this purpose. Before the assumption of Provincial Governments by Congress Ministries, the Government relied largely on the method of raising the price of liquor as high as possible, but not so high as to stimulate illicit production. Other steps taken to reduce the consumption of country spirit were rationing, reduction in the number of shops, lowering the limits of possession, reducing the strength of the drink supplied, curtailing the hours of sale, etc. Non-official opinion was inclined towards the restrictions of quantity and a strict regulation of the number of shops, together with the policy of local option and consultation of local opinion, in preference to high rates of excise duties. The Bombay Government adopted the policy of issuing fixed quantities annually on a progressively diminishing scale, so far as country liquor was concerned. The advent of the Congress Ministries pledged to a policy of prohibition in July 1937 imparted a new urgency to this problem. Most of them launched a programme of prohibition varying in intensity according to local conditions and the capacity of each to bear the consequent financial and administrative strain. The Madras Ministry gave a bold lead by applying prohibition throughout a whole district (Salem). Bihar did likewise. Bombay introduced total prohibition in the town of Ahmedabad (July 1938) and the town and island of Bombay (August 1939). Certain legal and technical difficulties in the way of enforcing prohibition in Bombay later (1940) resulted in partial relaxation of the policy of prohibition adopted by the Congress Government. Some provinces chose smaller areas, others took measures to restrict the sale of liquor by closure of shops, tightening up licensing control, and proclaiming 'dry' areas where there was to be no manufacture or sale of liquor—which could, however, be brought in from outside and consumed. Now that political independence is an accomplished fact and the Congress is firmly in the saddle vigorous efforts are being made to introduce prohibition by the Provincial Governments of the Indian Union.[1]

[1] The Pakistan Government has also declared itself in favour of the policy of prohibition. But it is not so deeply committed as the Congress Government to the principle of prohibition. It is therefore likely to approach the problem in a less reckless and more realistic spirit. Some of the provinces are moving very fast. For example, Madras introduced total prohibition with effect from 2 October 1948 (at the sacrifice of an annual revenue of

Opponents of prohibition, however, continue to urge that any impatient and drastic measures will be attended with the double difficulty of immediate and heavy loss of revenue and excessive expenditure for preventive establishment to put down smuggling and illicit distillation. Crores of rupees which might otherwise have been spent on education, irrigation and other nation-building activities will thus be wasted. These difficulties will clearly be most stupendous if complete prohibition at one stroke were to be attempted. Another danger is that vice suppressed violently in one direction is apt to break out in another direction, and often in a very much worse form. Thus it is complained that attempts to reduce the consumption of country spirit have in some cases been attended with an increased consumption of foreign liquor, and that people have even taken to methylated spirit in place of country liquor. The suppression of the evil, in order to be completely successful, must come as the result of a general realization on the part of the people that drunkenness is a crime, and this is a matter of education. Lastly it is important that there should be uniformity of policy on the drink problem throughout the whole country to prevent boot-legging and other nefarious practices.

However, even if these considerations have the effect of slowing down the policy of prohibition, a steady reduction in the revenue from excise hereafter will be inescapable.

§14. **Other sources of revenue.**—(i) *Stamps.*—Stamp revenue is derived from judicial and commercial stamps. The former represents fees on plaints and other documents in Civil and Criminal Courts. The latter represents duties on commercial transactions recorded in writing, such as conveyances as to the transfer of property, lands, bills of exchange and so forth. The revenue from judicial stamps is held by some to be not taxation proper, being a payment for the services rendered by a costly department, namely the Judicial Department. The revenue from stamps in 1939-40 amounted to Rs. 10·14 crores in British India. It has tended to increase in recent years in spite of Debt Relief Legislation in several provinces.

(ii) *Forests.*—The revenue under this head is derived mainly from the sale of timber and other produce, grazing fees and licence fees for permission to cut wood and other produce. The revenue is variable according to market conditions. Its further prospects are bright if the forests are properly nursed and exploited. The Provincial Governments, to whom forests have been assigned, were making a large net profit of about Rs. 2½ crores per year until the years of trade depression, when the net revenue fell heavily, being for example only Rs. 74·90 lakhs in 1933-4. The net annual revenue was only about Rs. 14 lakhs between 1864 and 1870. Large initial expenditure, however, is necessary for ensuring a still more substantial and steadily growing revenue from forests. The gross revenue from

about Rs. 17 crores). Bombay envisaged total prohibition in four years starting from 1947, and accordingly went completely dry from 6 April 1950. If other provinces are forced to move more slowly it is owing to financial considerations of an absolutely compelling character. But all are moving as fast as they dare in the same direction and have accepted total prohibition as the only solution of the drink problem.

forests amounted to Rs. 3·01 crores in 1939-40 as compared with Rs. 4·40 in 1936-7, i.e. before the separation of Burma from British India. Owing to abnormal war demand for timber the forest revenue rose considerably and still remains high.

(iii) *Registration.*—The revenue from registration is akin to judicial stamps revenue and is mainly derived from registration fees according to the value of the documents registered. Registration is compulsory in the case of certain documents relating to gifts and transactions in immoveable property, and optional in the case of others. Registration fees may be looked upon as payments for service rendered, the advantage lying in the consistency of deliberation, the publicity enforced on the parties and the provision of a record by way of satisfactory proof which may either prevent litigation or simplify its disposal by courts. The total revenue from this source is small (Rs. 1·18 crores for British India in 1939-40) but has latterly shown a tendency towards an increase.

(iv) *Scheduled Taxes.*—These are taxes which the provinces were empowered to impose under the Reforms (1921).[1] They have, however, not been much utilized, either because they are not very profitable or for other reasons. Betting and amusement taxes have been imposed in several provinces, e.g. Bengal, Bombay, Madras, the United Provinces, and Assam. Their yield is inconsiderable but is increasing.

§15. **New taxes under Provincial Autonomy.**—The introduction of Provincial Autonomy with effect from 1 April 1937 under the Government of India Act (1935) was responsible for the levy of some new taxes in the provinces which were empowered to impose them under the new constitution. The new taxation was designed to bridge the gulf between revenue and expenditure caused partly by the policy of prohibition adopted by the Congress Ministries and partly by the need for financing a programme of strengthening the social services. Among the new taxes introduced by the Provincial Governments mention may be made here of the sales taxes, the employment tax, and the immoveable property tax.

The Central Provinces Government were the first to exercise their power under the new constitution, by passing an Act (1938) imposing a tax on the retail sale of motor spirit and lubricants. Similar selective sales taxes were imposed by other provinces, e.g. the United Provinces, Bihar, Assam, Bombay, etc. The Bombay Sales Tax Act (1939) also provided for a selective sales tax on retail sales of two commodities, motor spirit and mechanically manufactured cloth. The sales tax on cloth was not, however, put into force owing to certain administrative difficulties. The Madras General Sales Tax Act (1939) was a comprehensive Act, and covers nearly all goods. The tax is levied in Madras on net turnover after making the necessary deductions from the gross turnover. A similar general tax on the sale of goods was imposed in Bengal by the Bengal Finance (Sales Tax) Act, 1941.[2]

[1] These are included in the Provincial Legislative List under the Constitution of 1935, see §37 below.

[2] Other commodities selected for sales taxation are electricity, tobacco, and articles of luxury such as motor cars, radio sets, etc. Sales of coal, coke and mica have recently (1948) been fully brought within the purview of the Sales Tax in Bihar.

Under the Employment Tax Bill passed in 1939 the United Provinces Government sought to levy a tax on the salaries of professional men on a graduated scale which in some cases amounted to as much as 10 per cent of the income of the taxpayer. Subsequently in conformity with an amendment of the Government of India Act, the tax had to be modified so as to limit the total amount payable in respect of any one person to Rs. 50 per annum. In 1939-40 the Government of Bengal levied an employment tax at the ungraduated rate of Rs. 30 per annum on all trades, professions, callings and employment, the tax being payable by those who are assessable to income-tax.

The Congress Ministry of Bombay decided in 1939 to levy a 10 per cent tax on rateable value on immoveable urban property in the cities of Bombay and Ahmedabad in order to meet the loss of excise revenue following the introduction of prohibition.

The sales taxes have been criticized on the ground that they tend to raise the cost of living, bring about wages disturbances, restrict consumption, hamper production and interfere with trade and business. The principal justification for them is productivity, which has naturally enough appealed to the needy Provincial Governments.

The new taxes gave rise to constitutional issues regarding the tax-jurisdiction of the Central Government and the Provincial Governments respectively. For instance, the petrol tax levied by the Government of the Central Provinces was challenged before the Federal Court by the Central Government on the plea that it encroached on the field of taxation (excise duties on production) reserved to them. The Federal Court decided in favour of the Provincial Government on the ground that while the Central Legislature had an exclusive power to impose duties on excisable articles before they became part of the general stock of the province (i.e. at the stage of manufacture or production), the Provincial Government had an exclusive power to impose a tax on sales thereafter. This favourable decision of the Federal Court has clarified the meaning of the provision 'taxes on the sale of goods' (see §37) and has thus opened a wide field of taxation for the provinces. At the same time, as the Chief Justice himself emphasized, there was an urgent need for mutual forbearance, lest the two taxing authorities should by the simultaneous exercise of their power in the realm of internal indirect taxation raise the price of the article taxed to a height at which consumption was seriously curtailed.

In the case of the Employment Tax the matter was decided by Parliament on the initiative taken by the Central Government and the Secretary of State. The amendment of the Government of India Act (1935) passed by Parliament in December 1939 definitely validates provincial laws relating to taxes on income in respect of professions, trades, callings and employment, but limits the total amount payable to Rs. 50 per head per annum. The limitation is justified on the ground that it was never intended that such provincial taxes should be so imposed as to constitute an income-tax and so trespass upon the Central field of revenues on the one hand, and on the other, to subject persons to unlimited taxation of their incomes by the Central and Provincial Governments.

§16. **War-time provincial finance.**—As a result of war conditions, provin-

cial finance experienced striking, if temporary, prosperity. The following table summarizes the position as regards provincial finances during the war years :

In lakhs of rupees

	1939-40	1940-1	1941-2	1942-3	1943-4	1944-5	1945-6
Revenue ..	90,83	97,48	1,07,41	1,24,31	1,63,31	2,08,18	2,29,33
Expenditure ..	89,22	95,18	1,03,48	1,18,18	1,53,85	2,04,28	2,18,14
Total Surpluses ..	2,02	3,21	4,52	6,46	13,04	8,63	11,44
Total Deficits ..	41	91	59	33	3,58	4,73	25
Net Surpluses + or Deficits— ..	+1,61	+2,30	+3,93	+6,13	+9,46	+3,90	+11,19

These figures show a continuous rise in revenue as well as expenditure after the outbreak of the war. The increase in revenue was due to such factors as rise in agricultural prices, increasing utilization of provincial resources like forests, additional or new taxation and the substantial rise from year to year in the provincial share in the Centre's divisible pool of income-tax. On the other hand the corresponding increase in expenditure was the result of additional expenses on police and civil defence measures, dearness and other allowances, outlays on food supply and distribution schemes, allocations of funds towards reduction of debts to the Centre and towards post-war development and reconstruction and enhanced expenditure on nation-building activities. The surplus in revenues revealed by the total figure for all the provinces during each of the war years is in striking contrast with the large deficits in the Central Government's budgets for the war years resulting mainly from the heavy defence expenditure. Most of the provinces showed surpluses during the war years, a notable exception being Bengal which had heavy deficits particularly in 1943-4 and 1944-5.[1]

Some of the new taxes levied by the provinces, such as the sales tax, were objected to as they are regressive in character. Champions of prohibition also naturally refused to rejoice over the extra yield from excise. Against the improved yield from forests must be set the ultimate loss to the country from the reckless destruction necessitated by the huge war demand for timber. However, provided these large additional funds are wisely spent on development projects and post-war reconstruction and rehabilitation, much good of a lasting character is likely to result.[2] The provinces have shown varying degrees of foresight in earmarking substantial amounts from their revenue surpluses for different purposes of economic development and social welfare. But careful and comprehensive planning on a national basis and proper coordination of effort between the Centre and the provinces are essential in order that maximum benefit may be derived from the relatively ample financial resources of the provinces.

§17. **Public expenditure in India.**—The following classification of public

[1] See *Report on Currency and Finance* (1946-7), par. 49.

[2] If the rise o iprices is taken into account the improvement in the financial position of the provinces is seen to be to some extent illusory. Nevertheless it remains true that provincial expenditure on the usual items has not gone up in proportion to increase in income.

expenditure in India may be adopted.[1] (i) *National defence*: Expenditure on army, navy, air force, frontier or strategic railways, harbours and defence works; military operations such as frontier expeditions, etc.

(ii) *Maintenance of internal peace and order.*—(*a*) Expenditure on police, courts of justice, jails; (*b*) general administration; (*c*) expenses with regard to collection of revenue; (*d*) political charges including the expenses of the legislative machinery; foreign representation by consuls, ambassadors, etc.; (*e*) pensions, furlough allowances, etc.

(iii) *National Development.*—Expenditure for (*a*) moral and (*b*) material development. Under the former may be included expenditure on education including scientific and miscellaneous departments, medical and sanitation charges; under the latter may be included expenses on railways, irrigation and public works, agriculture and famine charges, posts and telegraphs, interest on public debt. (The interest on unproductive or deadweight debt should strictly be included under (i) or (ii).)

§18. **Growth of public expenditure.**—The following table[2] shows the rapid growth of public expenditure since 1858-9:

PUBLIC EXPENDITURE IN INDIA (CENTRAL AND PROVINCIAL)
In crores of rupees

Year	Amount	Year	Amount
1858-9	50·19	1929-30	226·81
1898-9	58·29	1930-1	230·42
1899-1900	88·07	1931-2	220·09
1902-3	78·34	1932-3	209·55
1910-11	115·12	1933-4	205·27
1913-14	124·34	1935-6	209·76
1918-19	190·61	1936-7	211·18
1920-1	218·67	1937-8	205·58
1921-2	222·02	1938-9	207·47
1923-4	206·48	1944-5	496·71
1924-5	210·25	1945-6	360·23[3]
1925-6	215·75	1946-7 (Revised)	381·48
1926-7	221·82	1949-50 (Revised)	336
1927-8	218·73	1950-1 (Budget)	337·88
1928-9	222·21		

§19. **Criticism of public expenditure in India.**—The figures given in the table above show a striking and practically uninterrupted growth in public expenditure in India since the beginning of the present century, more especially since 1913-14 until the years of economic depression, which made a reduction of expenditure to some extent inevitable. As the late Mr Gokhale pointed out long ago, an increase in public expenditure need not necessarily be a matter for regret and

[1] Shah, *Sixty Years of Indian Finance.*, pp. 44-6.

[2] See K. T. Shah, *Sixty Years of Indian Finance* (second edition), p. 46; *Simon Commission Report*, vol. II, par. 254; *Statistical Abstract for British India* (1937-8), Table No. 111; and *Finance and Revenue Accounts of the Government of India* (1939-40), Tables No. 5 and 6.

[3] The fall in expenditure as compared to 1944-5 was due to a reduction in defence expenditure.

alarm. 'Everything depends in this matter on the nature of the purposes for which the increase has been incurred and the results produced by such outlay of public money. While increased expenditure in other countries, under popular control... has helped to bring increased strength and security to the nations, and increased enlightenment and prosperity to the people, our continually increasing expenditure has, under autocratic management, defective constitutional control and inherent defects of alien domination, only helped to bring about constantly increasing exploitation of our resources, has retarded our national progress, weakened our natural defences and burdened us with undefined and indefinite financial liabilities. Compelled to meet the demands of a forward imperial frontier policy and the exigencies of conquest, imperial defence and constant borrowing for commercial enterprises, often undertaken in consequence of the pressure of English commercial classes, our Indian Government has little money to spare, with all its increase of taxation, for purposes of national education....'[1] Mr Gokhale attributed a large part of the increase in public expenditure to the distrust and suspicion created by the Mutiny, which led to the wider employment of costly British services both in the civil and military branches.

The most serious growth in public expenditure was caused during and after the war of 1914-18. Our expenditure on military services was already high enough, namely Rs. 29·84 crores in 1913-14, but it rose by leaps and bounds to Rs. 66·72 crores in 1918-19, and Rs. 67·38 crores in 1920-1. Thereafter it was reduced, and stood at Rs. 54·92 crores in 1927-8. The military budget was stabilized in 1928-9 for four years at Rs. 55·1 crores (net).[2] The Inchcape Committee (1922-3) had recommended that the military expenditure should be brought down to a sum not exceeding Rs. 50 crores. The Simon Commission estimated that the army vote might drop to Rs. 52 crores when the programme of army mechanization was ended and thereafter would fall still further so as to conform to the lower level of prices, provided there was no change in policy. Large reductions in defence expenditure were made between 1936 and 1939, the net expenditure on defence after allowing for military receipts being Rs. 45·45 crores in 1936-7; Rs. 47·35 crores in 1937-8; Rs. 45·18 crores in 1938-9. This substantial reduction was due to the fall in prices, revision of the pay to the British soldiers, contribution of Rs. 2 crores by the British Government towards Indian military expenditure in accordance with the findings of the Capitation Tribunal, postponement of equipment programme, retrenchment and army pay cut. In 1938 the British Government agreed to contribute Rs. 80 lakhs towards the capital cost of mechanizing British cavalry and infantry units stationed in India. In the same year the British Government also agreed to forgo the annual contribution of £100,000 made by India towards her naval defence provided she undertook to maintain a sea-going fleet of not less than six modern escort vessels to be free to co-operate with the Royal Navy for the defence of India, and in addition to fulfil her responsibility for local defence of Indian ports. This arrangement was calculated to assist the development of the Royal Indian Navy.

[1] Written evidence of the late Mr G. K. Gokhale before the Welby Commission, 1897.
[2] The onset of the economic depression and financial stringency made it necessary to reduce the contract grant and to postpone the re-equipment programme.

§20. **Mounting defence expenditure during the war (1939-45).**—The expenditure on defence services increased enormously after the outbreak of war in September 1939, especially after 1941-2 after the entry of Japan into the war. From Rs. 49·54 crores in 1939-40 it rose to Rs. 73·61 crores in 1940-1, Rs. 103·93 crores in 1941-2, Rs. 267·13 crores in 1942-3, Rs. 395·86 crores in 1943-4 and reached the peak figure of Rs. 458·32 crores in 1944-5, the last full year of the war. The budget for 1950-1 provides for an expenditure of Rs. 168 crores for defence (which represents about 50 per cent of total expenditure).

Just before the outbreak of the war, the proposals of the Chatfield Committee for the modernization of the Army in India were accepted by His Majesty's Government and the Government of India. The Chatfield proposals also postulated the acceptance by the Government of India of joint responsibility for the external defence of India, and in accordance with this principle provided for the earmarking of certain portions of the defence forces of India for purposes of external defence and a consequential increase of £500,000 in the amount of the annual (Garron) grant of £1½ million made by His Majesty's Government towards the cost of maintaining the defence services in India in peace. The capital outlay on modernizing the army in India, which was estimated at Rs. 45·77 crores, was to have been provided by His Majesty's Government over a period of five years, three-fourths as a free gift to India and the balance of one-fourth as an advance to be repaid on easy terms. The outbreak of the war necessitated a review of these calculations, as the programme of modernization had to be adapted to the needs of the situation which then arose, and to the rise in prices since the war. Moreover, in India itself heavy expenditure had to be incurred in mobilizing production to the full, in increasing the manufacturing capacity of factories for the production of war stores of all kinds and in building up stocks. There was also a substantial increase in the defence expenditure due to the execution of various war measures designed to place India in a state of preparedness against attack. In view of all these factors a financial settlement was negotiated in November 1939 between His Majesty's Government and the Government of India, under which India was to bear:[1]

(i) her pre-war budget for effective charges of Rs. 36·77 crores;
(ii) an addition to allow for rise in prices (Rs. 3·55 crores);
(iii) the cost of such war measures as could be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interests (Rs. 35·40 crores); and
(iv) a lump sum payment of one crore of rupees towards the extra cost of maintaining India's External Defence troops overseas (Rs. 8·41 crores).

Total (i-iv)=Rs. 84·13 crores. The total amount by which the net annual defence expenditure incurred in India during the war years exceeded the aggregate of items (i)-(iii) was to be recovered from His Majesty's Government subject to separate post-war negotiations concerning the liability for surplus war stores in India acquired in the common interest. Non-effective charges were to be dealt with separately. India was

[1] Figures shown in brackets against each item relate to the Defence Budget for 1941-2. The financial settlement of 1939 was brought to an end on 31 March 1947.

to pay for whatever she took from Indian production for Indian war measures, and for her share of joint war measures, including storage charges, and His Majesty's Government was to pay for, and own, all the remaining stores produced, together with practically all the capital assets created for the purpose of expanding production and storage.

The object of the new settlement, as stated by the Finance Member, was to limit India's financial liability in connexion with the war to such measures as were within her financial capacity. Indian opinion, however, was critical of the new arrangement and is inclined to the view that the growing burden of defence expenditure, especially the extra cost of maintaining Indian troops overseas, was very onerous for a poor country like India.

The methods of economy that were suggested from time to time were reduction of the size of the army to the minimum required for strictly Indian purposes, and continuous and further acceleration of the process of Indianization so as to avoid expensive recruitment in England through the British War Office and heavy non-effective charges. The introduction of a short military service under the voluntary system was also suggested instead of maintaining the army during times of peace practically on a war establishment.

§21. **Expenditure on civil administration.**—The enormous increase in the expenditure on civil administration was another never-ending subject of criticism, the general complaint being that the Indian administration was one of the costliest in the world and that the scale of salaries and allowances given to the higher services, until recently manned largely by Europeans, was excessive. The Constitutional Reforms of 1919 and 1935 further added to the costliness of the administration in a variety of ways. The increases in salaries, allowances and other concessions granted by the Lee Commission (1924) and estimated to add to the national expenditure to the extent of Rs. 1¼ crores annually, were criticized as wholly unjustifiable on the ground that the original scales of pay were so high that no revision was called for in spite of the rise in prices. The subsequent fall in prices lent further point to this criticism. The real remedy was rapid Indianization with a reduction in the scale of salaries.

The expenditure on civil administration has increased tremendously since the outbreak of World War II. During the war there was no doubt need for a considerable expansion of many departments. But curiously enough after the termination of the war, the scale of expenditure was higher than during the war. The pre-war expenditure on general administration was Rs. 1·87 crores. During the peak war-period 1944-5 it was Rs. 4·24 crores. For 1946-7, it was Rs. 6·23 crores and for 1947-8 it was estimated to be reduced by only Rs. 9 lakhs.

Part of the recent increase in expenditure is due to the acceptance by Government of the recommendations of the Pay Commission. Some of it should disappear with the end of controls whenever it comes, because the system of economic controls of various kinds has necessitated an elaborate and expensive mechanism. In the nation-building departments expenditure has gone up from the pre-war figure of Rs. 2·17 crores to more than Rs. 18 crores. Developmental expenditure essential for the economic uplift of the people is necessary. But it is admitted on all hands that there is considerable scope for eliminating waste and reducing ex-

penditure. It is of the greatest importance that there should be a rigorous pursuit of economy in all the branches of administration, and those in charge of public funds must realize the fiduciary position which they occupy with regard to the taxpayer and display an exact diligence in the manner in which these funds are administered.

§22. **Burden of taxation.**—The Statistical Abstract for British India (1937-8) gives the figures shown in the following table bearing on the burden of taxation per head in British India.

In lakhs of rupees

	1922-3	1927-8	1933-4	1935-6	1937-8[1]
Total taxation, Central and Provincial (including land revenue[2])	1,32,79	1,40,18	1,30,79	1,39,37	1,31,93
Payment per head based on Census population in 1931[3] and assuming that the whole taxation is paid by the inhabitants of British India	Rs. AS. P. 5 4 5	Rs. AS. P. 5 5 0	Rs. AS. P. 4 10 10	Rs. AS. P. 4 14 3	Rs. AS. P. 4 12 11

Sir Purshotamdas Thakurdas, in his speech as a member of the commercial deputation on retrenchment, gave the following estimates of the incidence of taxation:

1871	..	Rs. 1-13-9	1911	..	Rs. 2-11-3
1881	..	,, 2- 2-3	1913	..	,, 2-14-5
1901	..	,, 2- 6-6	1922	..	,, 6- 1-8

According to these figures the nominal incidence of taxation in 1922 was more than double what it was in the period before the war of 1914-18. But whether this represents a really heavier burden depends on the figures we adopt for the *per capita* incomes for the two periods.[4]

Other special items of expenditure at present (1950) amounting to about Rs. 30 crores are relief of displaced persons, food subsidies and bonuses on production of food, expenses of the coming elections and certain pre-partition arrears of payment.

§23. **Distribution of the burden of taxation.**—The problem of the incidence of taxation is one of the most complicated in economic science and is rendered more so in India owing to lack of precise statistical information regarding the in-

[1] The incidence of taxation in recent years has increased appreciably owing to the additional Central taxation first imposed for financing the war, and later for development purposes, refugee rehabilitation, etc., as well as owing to new provincial taxation, and works out at more than Rs. 12 per head.

[2] We have already referred to the view of the Taxation Enquiry Committee that land revenue ought to be regarded as part of the burden of taxation. *Ante*, vol. I, ch. xii, §30

[3] Population figures for the intercensal period have been worked out on the assumption of a constant geometric rate of increase.

[4] *Ante*, ch. iv, §§1-7.

come *per capita* and the distribution of the national income. The Taxation Enquiry Committee were appointed in 1924 to examine the manner in which the burden of taxation was distributed and to consider *inter alia* whether the whole scheme of taxation, Central, Provincial and Local, was scientific and equitable. They selected a few typical classes of the population and offered certain tentative conclusions. The Committee found that the burden was oppressive on none of the classes, though its distribution was unequal. Some classes escaped their proper share of taxation, for example, the bigger landlords and the village trader.[1] Before 1914, taxation was very unevenly distributed between the different classes of the community. The poorer sections of the community bore the brunt of the burden in the shape of land revenue, salt tax, excise duties, stamps, etc., while the richer sections were able to escape their just share of taxation. The changes in taxation, during and after that war, while they certainly increased the burden on the masses, partially removed this blot on the taxation system of the country and made the incidence somewhat more equitable by the introduction of a graduated income-tax and super-tax, the levy of special import duties on luxury articles, etc. A considerable degree of inequality, however, still persisted, as is illustrated by the following figures worked out by Professor K. T. Shah with reference to the year 1923-4.[2]

In crores of rupees

Head of Revenue	Amount of the tax burden borne by	
	the rich strata	the poor strata
Customs	20	21
Land Revenue and Irrigation	20½	21½
Income-tax	20	..
Excise	..	20
Salt	1¼	7½
Forests and Registration	2	5
Stamps	6½	6½
Railways	33	60
Post Office	5	5½
Municipal Taxes	3	10
District Board Taxes	..	10
Total	111¼	167

From this table Professor Shah concluded that 'economically the weaker and less able section bore pecuniarily the largest proportion of the tax-burdens of India. Allowing for some *quid pro quo* in some of the above items (Railways, Post Office, etc.), we may yet say that while the richer class pays Rs. 100 crores in revenue, the poorer pays Rs. 150 crores, that is, in terms of wealth deduction ; while from the average family income of Rs. 1,000 per annum and over, the tax deduction aggregates Rs. 100 crores out of a total of Rs. 600 crores of wealth enjoyed by less than a twenty-fifth of the population, the remainder of Rs. 150 crores is deducted from a total wealth of about Rs. 1,000 or 1,200 crores enjoyed by the 96 per cent of the

[1] See *Taxation Enquiry Committee Report*, pars. 478-92.

[2] See Shah and Khambatta, *Wealth and Taxable Capacity*, pp. 289-91, and Shah, *Sixty Years of Indian Finance* (second edition), pp. 373-4.

remaining population. This distribution can scarcely be considered to be either economical or equitable.'

Mr A. C. Sampath Iyengar, Adviser to the Indian Chamber of Commerce, Calcutta, has recently (15 November 1949) published a study[1] in which he has attempted a statistical estimate of the distribution of the total burden of taxation, Central and Provincial, between the 'upper or middle class' and the 'lower class' taking an annual income of Rs. 2,000 as the line of demarcation between the two. The items of tax-revenue, Central as well as Provincial, in the budget statement for 1949-50 are classified as those towards which the 'lower class' makes no contribution and those towards which along with the 'upper class' they do make a contribution. Instances of the former are the income-tax, the corporation tax, taxes on professions, agricultural income-tax, Customs duties on such articles as foreign wines and spirits, boots and shoes, wireless instruments and appliances, tobacco, artificial silk yarn and thread, export duty on tea, excise on wines and commercial spirits and the Urban Immovable Property Tax. For articles in the other category a varying percentage contribution by the lower class is assumed. For instance, in the case of the import duty on betel-nuts and kerosene oil the percentage contribution of the 'lower class' is taken to be 75, whereas for spices it is 10, for sewing machines 35, and so on throughout all the items of revenue. The total population in the Indian Union (excluding the Indian Native States) is put down as 243 millions out of which roughly 30 millions belong to the 'upper' and 213 millions belong to the 'lower class'. On the basis of these figures, it is found that out of the total tax revenue of Rs. 466 crores, nearly Rs. 64 crores is contributed by the 'lower class', the balance being contributed by the 'upper class'. The *per capita* contribution for the lower sector is thus Rs. 2-15-10 as against Rs. 134-2-7 for the upper sector. To put it in another way, the 'upper class' constituting 12·4 per cent of the population contributes 86·33 per cent of the revenues, while the 'lower class' constituting 87·6 per cent of the population contributes only 13·67 per cent of the total revenues. It does not follow from this that the 'lower class' is lightly taxed, because the burden of taxation depends not only on the amount exacted but also the capacity to bear taxation, which is very small in the case of our poverty-stricken masses. The above figures may however legitimately be taken to prove that the upper classes in India are heavily taxed and that further increases in taxation are likely to be detrimental to the productive capacity of the people.

§24. **Broad view of Indian finance up to 1939.**—Owing to limitations of space it is impossible for us to enter into anything like a detailed history of Indian finance under the East India Company and the Crown. The confusion between the commercial and administrative accounts under the East India Compay; the chronic deficits which characterized the administration of the Company; the financial burdens of the Mutiny; the appointment in course of time of a separate Finance Member; the gradual progress in financial decentralization; the embarrassments caused by famines, frontier wars and fall in exchange; the loan policy of the Government; the budget surpluses of the years before the war of 1914-18, roughly

[1] *Who Contributes to the Exchequer?* published by the Employers' Association, Calcutta.

TABLE I[1]

In crores of rupees

Year	Revenue	Expenditure	Surplus (+) Deficit (−)	Year	Revenue	Expenditure	Surplus (+) Deficit (−)
1914-15	76·15	78·83	− 2·68	1918-19	1,30·40	1,33·13	− 5·73
1915-16	80·01	81·79	− 1·78	1919-20	1,37·14	1,60·79	− 23·65
1916-17	98·53	87·31	+ 11·22	1920-1	1,35·64	1,61·64	− 26·00
1917-18	1,18·70	1,06·57	+ 12·13				

TABLE II[2]

In crores of rupees

Year	Revenue excluding transfer from Revenue Reserve Fund (1)	Expenditure excluding transfer to Revenue Reserve Fund and provision for Reduction or Avoidance of Debt and items shown in (3) (2)	Transfer to Earthquake and other Funds (3)	Balance of (1) minus (2) minus (3) 4)	Transfer to or from Revenue Reserve Fund (5)	Provision for Reduction or Avoidance of Debt (6)	Final Surplus (+) Deficit (−) (7)
1921-2 ..	1,15·21	1,38·4	..	−23·19	..	4·46	−27·65
1922-3 ..	1,21·41	1,31·88	..	−10·47	..	4·55	−15·02
1923-4 ..	1,33·17	1,27·16	..	+ 6·01	..	3·62	+ 2·39
1924-5 ..	1,38·04	1,28·58	..	+ 9·46	..	3·78	+ 5·68
1925-6 ..	1,33·33	1,25·05	..	+ 8·28	..	4·97	+ 3·31
1926-7 ..	1,31·70	1,23·77	..	+ 7·93	−2·96	4·97	..
1927-8 ..	1,25·04	1,22·22	..	+ 2·82	2·22	5·04	..
1928-9 ..	1,28·24	1,23·88	..	+ 4·36	0·74	5·42	− 0·32
1929-30 ..	1,32·69	1,26·68	..	+ 6·01	..	5·74	+ 0·27
1930-1 ..	1,24·60	1,30·04	..	− 5·44	..	6·14	−11·58
1931-2 ..	1,21·64	1,26·50	..	− 4·86	..	6·89	−11·75
1932-3 ..	1,26·40	1,18·01	..	+ 8·39	..	6·84	+ 1·55
1933-4 ..	1,20·37	1,14·65	2·7[3]	+ 3·00	..	3·00	..
1934-5 ..	1,25·10	1,17·14	4·60[4]	+ 3·36	..	3·00	+ 0·36
1935-6 ..	1,22.01	1,16·72	0·45[5]	+ 4·84	−1·84	3·00	..
1936-7 (Revised)	1,18·98	1,17·90	..	+ 1·08	..	3·00	− 1·92

[1] These figures are exclusive of special items, such as transfers from and to the Revenue Reserve Fund and the appropriation of the balance at the credit of the German Liquidation account.

[2] *Central Budget for* 1937-8, p. 75.

[3] Amount transferred to the Earthquake Fund; 0·63 out of this was utilized for debt redemption.

[4] 2·82 for Rural Development, 0·25 for Tribal Areas in N.-W.F., 0·20 for Broadcasting, 0·93 for Civil Aviation and 0·40 for special grant to Road Fund.

[5] Fund for capital outlay on buildings in Sind 0·17 and Orissa 0·27.

TABLE III[1]

In crores of rupees

Year	Revenue	Expenditure	Surplus (+) Deficit (−)
1936-7	119·21	121·00	−1·79
1937-8[2]	122·48	122·48	..
1938-9	121·07	121·71	−0·63
1939-40 (Revised)	123·97	123·97	..

since the beginning of the present century—these are some of the topics belonging to the history of Indian finance.

The smooth course of India's pre-war finance and the era of budget surpluses came to an end abruptly with the outbreak of the First World War in 1914. Deficit budgets, drastic retrenchment, big reduction in the capital expenditure on railways and irrigation, increases in taxation under customs, income-tax, salt, and excise duties, and heavy borrowing in the Indian money market were the highlights of Indian finance during the war of 1914-18.

The tables above give the total Revenue and Expenditure (gross) of the Central Government before and after the Reforms of 1919 and also of the first three years of the new constitution of 1935 introduced in April 1937.

§25. **Deficit budgets.**—In contrast with the budget surpluses which characterized the period before 1914, there now set in a succession of deficit budgets in both Central and Provincial finance. In five years the aggregate deficit in the budgets of the Central Government alone amounted to nearly Rs.100 crores. On the top of the additional expenditure due to the European war, there was also the trouble caused by the wanton invasion of India by Afghanistan, which cost the Indian exchequer several crores of rupees. Again, the cost of civil and especially of military administration went on increasing year after year. The expenses of railway operations also showed a heavy increase, and the railway receipts suffered owing to the trade depression which followed on the heels of a short-lived boom at the end of the war. Apart from diminished railway receipts there was decreased yield from income-tax. The combined effect of all these factors was seen in the continuance of heavy deficits in spite of large increases in taxation between 1914 and 1922.

On the recommendations of the Retrenchment Committee[3] (1922-3), in 1923-4 a reduction of Rs. 6·6 crores in the non-military expenditure and Rs. 5·75 crores in military expenditure was effected. But this did not suffice to restore budget equilibrium and the Viceroy felt compelled to double the salt tax from Re. 1-4 to Rs. 2-8. In 1923-4 the tide turned and there was a temporary reversion

[1] The figures in this table are inclusive of extraordinary items such as transfers from or to Revenue Reserve Fund, and appropriation for reduction or avoidance of debt. As stated in §29, a sum of Rs. 3 crores has been provided for the last item on the expenditure side.

[2] Figures for 1937-8 are affected by changes due to the separation of Burma and the Niemeyer Award (see §38.) The net cost of the separation of Burma was Rs. 2·33 crores. Provincial Autonomy involved a total cost to the Centre of Rs. 1·85 crores.

[3] See *Report of the Retrenchment Committee*, part XI, par. 8.

to the old tendency of surplus budgets due to excessive caution in revenue estimates, the stabilization of the rupee at 1*s.* 6*d.*, the retention of the high level of taxation previously introduced and the gradual recovery of trade and industry. These surpluses were utilized to abolish Provincial contributions and reduce the unproductive debt. After 1927-8, however, budget equilibrium was again disturbed and, after the final remission of the Provincial contributions, there was a succession of deficit years, and the gap caused in the revenue by the remission of contributions had to be closed either by transfers from the Revenue Reserve Fund (which was thus completely exhausted) as in 1927-8 and 1928-9, or by the German reparations payment as in 1929-30. This fact, coupled with a fall in the contribution from the railways to the General Revenues, essential new services and demands involving Rs. 1,46 lakhs, created a deficit of Rs. 5,52 lakhs which was met partly by reduction in expenditure and partly by additional taxation imposed in 1930-1.

§26. **Indian finance in the years of depression and after.**[1]—An acute financial crisis overtook the Central Budget (as most of the Provincial Budgets) in 1930-3, owing mainly to the prolonged and severe economic depression and the heavy fall in prices. This led to serious deterioration of many of the important revenue heads such as customs and taxes on income, and adversely affected the earnings of commercial departments like Railways and Posts and Telegraphs. The situation was for some time aggravated by internal disturbances and uncertainty caused by the prospect of fundamental constitutional changes.

We may now mention the outstanding features of the Central finance during the depression period. The revised estimates for 1930-1 revealed a net deficit of Rs. 13·56 crores as against a final budgeted surplus of Rs. 86 lakhs. The deficit on the basis of 1930-1 figures of revenue and expenditure was expected to be Rs. 17·24 crores, which the Finance Member proposed to reduce, by retrenchment in military expenditure of Rs. 1·75 crores and 0·98 crores in civil expenditure, to 14·51 crores in 1931-2. The deficit was to be covered by 14·82 crores of taxes, of which customs duties were calculated to yield 9·82 crores and income-tax 5 crores, thus providing for 31 lakhs of surplus. These calculations were upset during the next six months, and an emergency arose from the fact that the previous (March 1931) Bill would not yield sufficient income to meet the Government's needs. To meet the emergency Sir George Schuster introduced a Supplementary Finance Bill in the Assembly in September 1931. It was to remain in force for a period of 18 months (till March 1933). The deficit for 1931-2 was expected to be Rs. 19·55 crores and for 1932-3 Rs. 19·50 crores. Thus a total deficit of Rs.39·05 crores had to be repaired during a period of 18 months. This gulf was to be bridged to the extent of $\frac{1}{3}$ by retrenchment and an emergency cut (10 per cent) in salaries, and to the extent of $\frac{2}{3}$ by more than Rs. 22 crores of new taxation. The changes in taxation affecting customs duties and income-tax have already been noticed. A surcharge of $\frac{1}{4}$ on all existing excise duties, including salt, and increased postal rates were other measures of addi-

[1] Successive changes in taxation and customs tariff noted already under the different central heads of revenue are again grouped together in §§26 and 27 under the budget changes from year to year.

tional taxation. The immediate object of the Supplementary Budget was thus fulfilled and the gap in the budget was not only filled up, but, as the actual figures for 1932-3 revealed, there was a surplus of Rs. 1,55 lakhs after providing nearly Rs. 7 crores for reduction of debt. This result was secured partly by retrenchment, but mainly by additional heavy taxation aggregating Rs. 42 crores in three years.

The Budget for 1933-4 restored half of the pay-cut and the Budget for 1935-6 provided for the full restoration of the cut. The year 1933-4 showed a surplus of Rs. 2·72 crores after the reduced provision of Rs. 3 crores for debt reduction had been made. This surplus was largely transferred to the Earthquake Fund to finance relief measures in respect of the damage caused by the earthquake in Bihar and Orissa in 1934. The only relief the taxpayer secured was a reduction in the rate of income-tax from 4 pies to 2 pies on incomes between Rs. 1,000 and 1,499. On the other hand, the Budget for 1934-5 introduced new taxation (sugar and match excise duties). The sugar excise was intended to meet a deficit of Rs. 1,53 lakhs in the revenue. The export duty on raw hides was, however, abolished and the silver duty was reduced to 5 as. per ounce. The actual figures for 1934-5 showed a material improvement over the original forecast, and a surplus of Rs. 4,95 lakhs was realized. This surplus was utilized for various objects including the grant of Rs. 2,81 lakhs to the Provincial Governments for constituting a Fund for the economic development and the improvement of rural areas. The Budget estimates for 1935-6, on the existing basis of taxation, showed a surplus of Rs. 1,50 lakhs which was available for tax reduction. The abolition of the export duty on raw skins reduced the surplus to Rs. 1,42 lakhs. In pursuance of their promise the Government provided for a reduction in the surcharge and the tax on small incomes by one-third. The actual figures showed a surplus of Rs. 2,29 lakhs as compared to a nominal surplus estimated at Rs. 5 lakhs, owing to trade recovery among other factors. This surplus was to be utilized for (i) building equipment in Sind (Rs. 17½ lakhs) and Orissa (Rs. 27½ lakhs) and for (ii) transferring to the Revenue Reserve Fund Rs. 1,84 lakhs for assisting the Central Budget in the first year of Provincial Autonomy.

The Budget for 1936-7 estimated a surplus of Rs. 2,05 lakhs, which was to be utilized (i) for giving relief to the small income-tax payer by abolishing taxes on incomes below Rs. 2,000; (ii) for reduction by half of surcharges on income-tax and super-tax; and (iii) for increasing the weight of a letter carried for one anna from half a tola to one tola; leaving on hand a small surplus balance of Rs. 6 lakhs. Owing, however, mainly to deterioration in revenue following trade depression, especially under customs and partially income-tax, the revised figures for 1936-7 showed a deficit of Rs. 1,92 lakhs (the actual deficit was later found to be 1,79 lakhs). To fill the gap in the revenue, sugar excise duties were raised as indicated in §4, and the duty on silver was increased to 3 as. per ounce in 1937. On the basis of this taxation a small surplus of Rs. 7 lakhs was estimated in the Budget for the year 1937-8. The revised estimates for 1937-8 showed a total improvement of Rs. 3,90 lakhs in revenue under customs and central excise duties owing mainly to trade recovery and increased railway earnings. On the other hand, there was an increase of Rs. 3,22 lakhs in expenditure, partly under Defence services mainly caused by the cost of operations in Waziristan and partly under other

items. Thus the net improvement was only Rs. 68 lakhs. The Budget estimates had provided for a nominal surplus of Rs. 7 lakhs after the utilization of the whole of the Revenue Reserve Fund of Rs. 1,84 lakhs. The actual amount required for balancing the Budget was, however, only Rs. 78 lakhs.

The Budget for the year 1938-9 provided for a small surplus of Rs. 9 lakhs. The Finance Member in his 1938 Budget Speech claimed that it had been possible to provide the cost of the introduction of Provincial Autonomy, the separation of Burma (which caused a loss of Rs. 2,50 lakhs) and the expenditure on the Waziristan expedition ; to make a start on the distribution of income-tax to the Provinces under the Niemeyer Award (see §§39 and 42) ; and at the same time to show balanced budgets both in 1937-8 and 1938-9 without the imposition of any new taxation. This was made possible by a steady improvement of trade conditions throughout 1937. This increased the revenues by Rs. 3·90 crores, mainly from receipts from customs and railways as pointed out above. The revised estimates for 1938-9 showed a net deterioration of Rs. 2,92 lakhs in revenue, mainly because of a severe fall under customs under the influence of the trade recession. Under expenditure there was a net diminution of Rs. 18 lakhs. Thus instead of a surplus of 9 lakhs the result was a deficit of about Rs. 2,65 lakhs. In the event, however, the actual deficit turned out to be no more than Rs. 64 lakhs, due to an improvement of Rs. 1,51 lakhs in revenue and a reduction of Rs. 50 lakhs in expenditure.

§27. **Indian finance since 1939.**—In 1939-40 trade recession still continued to affect the revenue position adversely, especially under customs ; and in spite of the increased yield from income-tax under the newly introduced slab system and of economies under Interest and Defence, there remained a deficit of Rs. 50 lakhs to be covered. This was achieved by doubling the import duty on raw cotton.[1] Due to the outbreak of war in September 1939, the budgetary position underwent a striking change in subsequent months. In place of an anticipated surplus of Rs. 3 lakhs, the revised estimates disclosed a surplus of Rs. 91 lakhs, being the result of an increase of Rs. 5,08 lakhs in revenue under railways, income-tax, salt, currency, etc., as against an increase of Rs. 4,20 lakhs under expenditure, being mainly due to additional expenditure on defence (see § 20). The final results for the year 1939-40 revealed a surplus of Rs. 7,77 lakhs, making it possible to increase the amount transferred to the Revenue Reserve Fund by Rs. 6,86 lakhs. This was the result of an improvement of Rs. 6,81 lakhs in revenue and a reduction of Rs. 5 lakhs in expenditure on the revenue side. Customs duties, after a sharp drop at the outbreak of the war, were abnormally high during the closing months of the year, mainly owing to the laying-in of stocks. The Railway earnings, income-tax, salt, currency and mint also showed further increases.

India's first War Budget (1940-1).—The first war budget for a whole year indicated the necessity of finding new revenue to meet a prospective deficit of Rs. 7,16 lakhs, caused almost entirely by the additional requirements of Government owing to the war, in spite of greatly increased contribution from the railways. The Defence Budget alone amounted to Rs. 52·52 crores. The deficit was reduced to Rs. 6,25 lakhs with the help of the surplus of Rs. 91 lakhs according to the revised estimates for 1939-40. The Finance Member proposed to

[1] From 6 pies per lb. to an anna per lb.

meet this deficit from additional taxation, direct and indirect, as follows: (i) Excess Profits Tax at the rate of 50 per cent on war profits (Rs. 3,00 lakhs), (ii) a rupee per cwt. more on sugar excise (Rs. 1,50 lakhs) and (iii) 2 annas more on motor spirit (Rs. 1,40 lakhs), thus leaving a nominal surplus of Rs. 5 lakhs in the 1940-1 Budget.

Supplementary Finance Act (November, 1940).—The greatly increased war expenditure, much in excess of the original estimate, called for fresh taxation proposals, which were embodied in a second Finance Bill introduced by Sir Jeremy Raisman on 5 November 1940. The position was that an increase in the Defence Budget of at least Rs. 14½ crores and of Rs. 2½ crores in civil expenditure had to be provided for, and that against the extra balance of Rs. 7 crores available in the Revenue Reserve Fund had to be set off a drop of Rs. 3 crores in revenue in the year 1940-1. There was thus a prospective deficit of roughly Rs. 15 crores. Besides, there were heavy commitments in regard to defence measures involving a recurring increase of Rs. 16 crores in a full year and a non-recurring expenditure of well over Rs. 30 crores to be spread over the next year or two. The new taxation proposals provided for a 25 per cent federal surcharge on all taxes on income, including super-tax and corporation tax, and an increase in the postal rates.

The 1941-2 Budget revealed a deficit of Rs. 8·42 crores in the year 1940-1 (revised estimates) and a prospective heavy deficit of Rs. 20·40 crores in 1941-2. The revised estimates for 1940-1, excluding the additional Rs. 6·86 crores available in the Revenue Reserve Fund, showed a net improvement of Rs. 4·21 crores compared with the Budget estimates. Against this, however, the revised estimate for expenditure showed a net increase of Rs. 19·54 crores, mostly in connexion with Defence Services and schemes connected with the war. Thus while the Budget estimates for 1940-1 provided for a nominal surplus of Rs. 5 lakhs, and in November the deficit was estimated at Rs. 13 crores, before taking into account the revenue from the fresh taxation then imposed, the deficit according to the revised estimates for the whole year 1940-1 amounted to Rs. 8·42 crores. The improvement was due to the additional revenue that accrued, including the further payment of Rs. 2·81 crores from the Railways as a refund of arrears of contribution. The deficit of Rs. 8·42 crores was reduced to Rs. 5·43 crores by the use of Rs. 3 crores provided in the Budget for the reduction or avoidance of debt, and therefore the net addition to Government's indebtedness was only of the order of Rs. 5½ crores.

The prospective heavy deficit of Rs. 20·40 crores for the year 1941-2 arose from the big Defence Budget estimated at Rs. 84·13 crores and the increase in Civil estimates due to schemes connected with the war. It was proposed to meet this deficit by resorting to fresh taxation to the tune of Rs. 6·61 crores, and to borrow the rest. In the sphere of direct taxation, the new taxation proposals increased the Excess Profits Tax from 50 to 66⅔ per cent (Rs. 2·50 crores) and raised the Central surcharge on income-tax and super-tax from 25 to 33 1/3 per cent (Rs. 0·90 crores). In the field of indirect taxation, the excise duty on matches was doubled, with a corresponding increase in the import duty (Rs. 1·50 crores). Besides this there were two other smaller proposals, namely, to increase the import

duty on artificial silk yarn from 3 as. per lb. to 5 as. per lb., and to impose a new excise duty of 10 per cent *ad valorem* on pneumatic tyres and tubes manufactured in India (Rs. 35 lakhs).

Presenting the Budget for 1942-3, the Finance Member disclosed a revenue deficit of Rs. 17 crores for the year and a prospective deficit of Rs. 47 crores for the next year. The estimate on Defence for 1942-3 was placed at Rs. 133 crores. It was proposed to meet the deficit by raising Rs. 35 crores by loans and Rs. 12 crores by taxation. The new taxes included (i) surcharge on income-tax and increase of super-tax, (ii) an all-round customs surcharge of 20 per cent and (iii) increase of postal tax and postal telegraph rates.

The 1943-4 Budget estimated revenue at Rs. 199·3 crores as compared with Rs. 178·76 crores in the revised estimates for 1942-3. The total expenditure was expected to be Rs. 259·59 crores. The deficit of Rs. 60·29 crores was to be covered by Rs. 20·1 crores of new taxation and the rest by borrowing. The revised estimates for the year showed an improvement of Rs. 35·50 crores, while there was a net increase of Rs. 87·34 crores under expenditure. Thus the revenue deficit expected at the close of the year was Rs. 92·43 crores.

In the Budget year 1944-5, the total revenue at the existing level of taxation was estimated at Rs. 284·97 crores and the total expenditure at Rs. 363·18 crores so that the prospective revenue deficit was Rs. 78·21 crores which was to be met partly by taxation and partly by compulsory deposit; an important source of revenue was a provision for advance payments of tax on income not subjected to deduction at source. The compulsory deposit of one-fifth of the Excess Profits Tax was increased to 19/64 of the tax with the object of immobilizing the whole of the excess profits. Other measures of taxation proposed were raising the scale of income-tax (Rs. 8½ crores), increased surcharge on tobacco and spirits (Rs. 1 crore), increased excise duty on tobacco (Rs. 10 crores), and bringing betel-nuts, coffee and tea under the Central Excise Tariff. The total effect of new taxation and compulsory deposits was expected to be Rs. 100 crores, i.e. about Rs. 22 crores in excess of the deficit foreshadowed.

The defence expenditure was estimated at Rs. 276·61 crores and Rs. 24·60 crores under the revenue and capital heads respectively. (Actually the peak figure of Rs. 458·32 crores was reached during this year.)

The budget proposals for 1944-5 immobilized as deposits the whole of the excess profits remaining after the excess profits tax had been paid on them and income-tax and super-tax had been paid on the balance. The assessee of the compulsory deposit was to be allowed to withdraw it within two months of the termination of hostilities or two years from the payment of the deposit whichever was later, and was in the meanwhile to get 2 per cent interest.

The total revenue estimates for 1945-6 were placed at Rs. 353·74 crores. The defence estimates amounted to Rs. 394·23 crores and Rs. 59·41 crores for the revenue and capital heads respectively. The expenditure on civil estimates was put at Rs. 123·40 crores. The prospective deficit of Rs. 163·89 crores was to be met mainly by borrowing to the extent of Rs. 155·29 crores and by taxation only to the extent of Rs. 8·60 crores (by raising the tobacco duty, by increasing the rate on postal parcels and the surcharge on telegrams, telephone rentals and

trunk call fees). For the first time the budget differentiated between earned and unearned incomes.

The first peace-time budget had for its background the possible effects on the country's economy of a steep fall in war-time expenditure and income levels, as well as the continued need closely to watch and control the position arising from the war-time legacy of inflation. In attempting to smooth the transition from war to peace and in the wider aspects of post-war planning, the budget laid special stress on subordinating fiscal policies to the broader aims of national economy. The revenue receipts were estimated at Rs. 311·65 crores and expenditure at Rs. 355·71 crores and therefore the expected deficit was Rs. 44·06 crores. The estimated revenue was smaller by more than Rs. 49 crores as compared to the revised revenue estimate of the previous year, the decline being mainly due to concessions to taxpayers, especially those in industries and persons with moderate incomes. The relatively large outlay of Rs. 243·77 crores on defence even after the war was over was mainly accounted for by the demobilization programme. Civil expenditure was estimated at Rs. 111·94 crores.

Budget estimates, 1947-8, placed expenditure at Rs. 327·88 crores and revenue at Rs. 279·42 crores on the basis of existing taxation. The resulting prospective deficit was Rs. 48·46 crores. Defence expenditure was estimated at Rs. 188·71 crores and civil expenditure at Rs. 139·17 crores.

The financial history of India in 1947-8 can be divided into two parts—pre-partition and post-partition. The revenue deficit of Rs. 48·46 crores referred to above in the pre-partition budget increased by another Rs. 8·24 crores to Rs. 56·7 crores on account of the abolition of the salt tax. As the result of the modifications effected by the Legislature in the taxation proposals, Rs. 27·2 crores of the deficit was proposed to be covered leaving a revenue deficit of Rs. 29·5 uncovered.

Post-partition budget.—The interim budget covered a period of 7½ months and provided for a revenue of Rs. 171·2 crores and expenditure on revenue account of Rs. 197·4 crores and a revenue deficit of Rs. 26·2 crores. A small part of this deficit—Rs. 1·6 crores—was to be covered by replacing the existing *ad valorem* duty of 3 per cent by a specific duty of 4 as. per square yard on cotton cloth and 6 as. a lb. on cotton yarn. The uncovered deficit was Rs. 24·6 crores, which was due to abnormal factors like expenditure estimates of Rs. 22 crores for the evacuation and relief of refugees and Rs. 22·5 crores as subsidies for imported food-grains. The apparently excessive figure of Rs. 92·7 crores for defence expenditure was due to the slowing down of demobilization following the partition of the country and the necessity of maintaining larger forces than would be necessary in normal times. Out of the total civil expenditure of Rs. 104·7 crores, Rs. 18·5 crores was for administration and Rs. 12 crores for nation-building activities. In addition provision was made in the Central Budget for a grant of Rs. 10·4 crores to Provincial Governments for development and Rs. 15 crores for loans.

The revised estimates for the 7½ months covered by the interim budget showed an increase of Rs. 5·97 crores on the revenue side and a decrease of Rs. 12·10 crores on the expenditure side.

The revised estimate for 1948-9 placed revenue receipts at Rs. 338·32 crores and expenditure at Rs. 339·87 crores. On the expenditure side the increase of

Rs. 82·49 crores over the budget estimate was mainly due to the operations in Kashmir and the police action in Hyderabad. The increase of civil expenditure by Rs. 48·14 crores over the budget estimate was chiefly due to (i) a new provision of Rs. 20·75 crores for pre-partition liabilities, (ii) an increase of Rs. 12·05 crores in the expenditure on the subsidizing of imported food-grains and on bonuses to Provincial Governments on internal procurement, and (iii) higher expenditure on relief and rehabilitation.

The budget estimates for 1949-50 placed total revenue at about Rs. 323 crores and total expenditure at Rs. 322½ crores. The revised estimates showed revenue of a little over Rs. 332 crores and expenditure of a little over Rs. 336 crores, the deficit thus amounting to Rs. 3·74 crores. The defence expenditure increased by about Rs. 12⅔ crores. Against this customs revenue increased by about Rs. 9 crores over the estimated figure. The difference between these two items was almost equal to the deficit. The defence expenditure had to be maintained at a high level as the peaceful solution of the Kashmir problem which was anticipated failed to come about. The improvement in customs revenue was due to a liberal import policy and greater yield from export duties after devaluation.

At the existing level of taxation the total revenue for 1950-1 is estimated at Rs. 347·5 crores and the total expenditure at Rs. 337·88 crores, leaving a surplus of Rs. 9·62 crores. On the revenue side, customs are expected to drop by nearly Rs. 14 crores owing to the policy of strict limitation of imports, whereas income-tax shows an increase of nearly Rs. 35 crores owing to three factors: (i) receipts from the integrated States, (ii) prompter collection and better recoveries of arrears, (iii) advanced payments made under section 18A of the Income Tax Act. On the expenditure side the provision for defence is Rs. 168 crores as against Rs. 170 (revised estimate) in 1949-50.

The table opposite gives the receipts and disbursements of the Government of India under capital heads for four years from 1947-8 to 1949-50.[1]

§28. **A review of the public debt in India.**—The origin of our public debt is to be traced to the wars of the East India Company which had steadily taken up the figure for national debt from £7 millions in 1792 to £59½ millions just before the Mutiny in 1856-7. In the following year the figure rose to £60 1/3 millions. The whole charge of the Mutiny was thrown on India so that the total public debt amounted in 1860 to over £100 millions. When the Company's rule was abolished in 1858, the Government of India not only assumed responsibility for the territorial and other debts of the Company but also for the payment of the dividend on the capital stock of £12 millions of the East India Company, until in 1874 the East India stock was redeemed. The debt inherited by the Government of India from the Company was purely unproductive. Since 1867, however, when the policy of constructing 'extraordinary public works' (or 'productive works' as they came to be called later on) like railways and irrigation, commenced, there has been a steady growth in the amount of productive or 'Public Works Debt' as distinguished from 'Ordinary Debt', as the unproductive debt came to be called from 1879. Additions to the former debt were made when the Government had to borrow for

[1] *Report on Currency and Finance*, 1948-9, p. 109.

RECEIPTS AND DISBURSEMENTS OF THE GOVERNMENT OF INDIA UNDER CAPITAL HEADS

In lakhs of rupees

Receipts	1947-8[1] Revised	1948-9 Budget	1948-9 Revised	1949-50 Budget
New Loans	40,95	150,00	55,04	85,00
Treasury Bills[2]	10,00	10,00	270,65	—
Treasury Deposit Receipts[2] ..	..	..	4,00	5,00
Small Savings[2]	9,11	31,25	32,85	37,56
Other Unfunded Debt[2]	20	1,07	93	1,79
Railway Depreciation and Reserve Funds[2]	7,03	7,64	3,98	17,66
Railway Betterment Fund[2] ..	1	11	8	32
Appropriation for Reduction or Avoidance of Debt[2]	5,00	5,00	5,00	5,00
E.P.T. and Income-tax Deposits[2] ..	61,68	39,06	40,82	35,09
Repayment of Loans by Provinces ..	4,39	4,45	5,57	4,92
Other items	9,87	22,88	29,78	18,33
TOTAL RECEIPTS	7,83	174,00	356,56	106,78
Deficit on Capital Account ..	133,41	112,57	185,09	134,10
GRAND TOTAL	141,24	286,57	541,65	240,88

Disbursements	1947-8[1] Revised	1948-9 Budget	1948-9 Revised	1949-50 Budget
Railways	16,79	24,45	27,15	28,49
Industrial Development	6,13	7,88	10,94	13,15
Currency and Mint	79	72	6,80	92
Defence Capital Outlay	..	14,99	91,66	3,20
Grants to Provinces for Development ..	20,39	30,00	18,00	26,81
Discharge of Permanent Debt ..	59,57	103,78	104,95	71,64
Other Loans and Advances[2] ..	2,33	16,66	7,14	16,37
Advances to Provincial Governments ..	22,45	38,00	38,92	58,25
Other items	12,79	50,09	236,09	22,05
TOTAL DISBURSEMENTS ..	141,24	286,57	541,65	240,88
GRAND TOTAL	141,24	286,57	541,65	240,88

purchasing some of the railways from the companies or for making advances to them. In conformity with the recommendations made by the Select Committee of 1878 the surplus revenue of a particular year was not applied to the cancellation of debt but spent on productive works for which the Government would otherwise have been required to borrow. The reduction of the ordinary debt was thus automatically followed by an equivalent increase in the public works debt. By this process the ordinary debt would have been wiped off altogether by 1917 but for the huge addition to the debt for which the war was responsible. The late Mr Gokhale was a strong critic of the policy of utilizing the surplus revenue for reducing the ordinary debt and increasing the productive debt. He contended that in view of the smallness of the unproductive debt, there was no need to liquidate it out of Government's ordinary surpluses, which ought to have been returned to the taxpayer by remission of taxation or, better still, spent on beneficial

[1] The budget covers only 7½ months from 15 August 1947 to 31 March 1948.

[2] Figures are net.

non-recurring expenditure, such as education, medical relief, etc., to be met from special Provincial reserves to which the Imperial Government might have made grants from their surpluses.

By far the greater portion of the public debt of India during the period before the war of 1914-18 was raised in England. The Government defended this policy on the ground that the difference between the rates of interest in India and in England was so considerable as to counterbalance any disadvantages attendant upon borrowing in England. They had also a very poor idea of the resources of the Indian money market, whose maximum lending capacity in any single year they put at not more than Rs. 5 crores. It was left to the war (1914-18) and post-war period to prove that this was very much of an underestimate. During this period the ordinary debt increased rapidly from Rs. 3·1 crores on 31 March 1916 to Rs. 257·70 crores on 31 March 1924. This was due to India's war contribution of £100 millions,[1] the expense on New Delhi and the post-war era of successive deficits in the budget of the Central Government. Successive War Loans were raised in India to meet some of these demands, as the English money market was fully taxed by the demands made on it by the British Government for war purposes, and the Government were able to get the unprecedented amounts of Rs. 53 crores in 1917, and Rs. 57 crores in 1918. The strength of the Indian money market for Government loans, first revealed during the war period, was largely maintained during the post-war years. Apart from the large amounts raised by the War Loans, another feature of these loans was the increase in the number of investors, thanks to effective advertisement and offer of increased facilities in regard to the administration of the Public Debt at Government treasuries and sub-treasuries. In this connexion special mention must be made of the Post Office branch of the War Loans and the system of Cash Certificates which secured a place in the Government's loan policy.

Another innovation which owed its birth to the war of 1914-18 was the introduction of Treasury Bills, first issued in 1917 for meeting the Government's disbursements on behalf of the British War Office. They were again resorted to for financing the deficits in the post-war period, when the old bills were paid by issuing new bills. Ultimately the large outstanding amounts of Treasury Bills were reduced by discharging these bills from the proceeds of long-term loans—a questionable procedure from the point of view of sound finance. Since the year 1929-30 the issue of Treasury Bills has again become a normal feature of Central finance.

Mention may be made here of the Indian Defence Savings movement in connexion with the recent war which was launched early in June 1940 with the issue of 3 per cent six-year Defence Bonds, ten-year Defence Savings Certificates and Interest-Free Bonds. The six-year Defence Bonds were the mainstay of the War Loan programme of the Government, and subscriptions to these totalled nearly Rs. 45 crores, 31½ crores being tendered in cash and the balance by conversion of the 5 per cent Loan (1940-3). As from 1 February 1941, a second 3 per cent Defence Loan with a longer currency and repayable at par was issued in place of

[1] An additional war contribution of £45 millions was promised in 1918 in the event of the war being prolonged. But in 1919-20, in view of the heavy expenditure of £16 millions due to the Afghan war, the additional war contribution was substantially reduced.

the six-year Defence Bonds. The subscriptions to the Defence Loans during 1942-3 amounted to Rs. 115 crores. There were later a third and a fourth Defence Loan and several other loans which yielded a total of Rs. 279 crores during 1943-4, taking the aggregate since the beginning of the war to Rs. 547 crores. In addition to the loans already described, a Defence Savings Provident Fund for all Government servants was started which made it easy for these classes to make regular investments. A simple system of facilitating popular savings was also introduced by means of a new scheme of Post Office Defence Savings Bank Accounts, the amounts in which were repayable not on demand but a year after the end of the war. In order to encourage deposits of this kind, the rate of interest was fixed at 1 per cent higher than the existing rate on ordinary Postal Savings Banks Accounts.

The total regular interest-bearing debt on 31 March 1939 amounted to Rs. 1,158 crores, comprising Sterling loans and Railway Annuities Rs. 445 crores, Rupee loans and Treasury Bills Rs. 484 crores, and Unfunded debt (Cash Certificates, Savings Bank Deposits and Provident Funds) Rs. 229 crores.

The following are the salient features of the Public Debt position in India since 1937-8 : (i) a steady increase in the total interest-bearing obligations of the Government of India (including unfunded debt and deposits), (ii) a steady rise up to 1942-3 in the amount of terminable and non-terminable loans, partly issued in connexion with the repatriation of sterling debt, (iii) considerable increase up to 1942-3 in floating debt represented by treasury bills outstanding to about six times their pre-war amount, largely issued on account of repatriation of sterling debt, (iv) heavy decline in that volume during the subsequent four years *pari passu* with the large increase in the volume of funded debt, (v) decline up to 1942-3 in the amount of small savings followed by a rapid recovery in subsequent years (primarily owing to the introduction of National Savings Certificates) and (vi) practical elimination of sterling loans which before the war actually exceeded the volume of rupee loans.

The year 1942-3 marked the beginning of a new phase in war-time financial developments marked by a rise in the rate of increase in public debt, which accompanied the increase in budgetary deficits, and inflationary pressure following rapidly mounting war expenditure in India.

The table on p. 404 gives figures for the various categories of India's public debt from 1939-40 to 1949-50.

§29. **Debt redemption.**—In the period before the war of 1914-18, the public debt of India was being reduced in two ways. One of these has been already noticed, namely the utilization of surpluses for capital expenditure on railways, irrigation, etc., which enabled the Government to avoid borrowing and to reduce the unproductive debt to that extent. The second method was adopted to meet the liability incurred in connexion with the purchase of certain railways. A portion of this liability was and is being reduced under the statutory obligation of payment of railway annuities (issued in repayment of both principal and interest on loans). So also the India Stock, for which the shareholders of railways were permitted to exchange their annuities and the securities of the original companies from which the railways were purchased, was being reduced from certain sinking funds shown under railway account. During the war of 1914-18 a

sinking fund was established in connexion with the issue of the 5 per cent War Loan of 1917. The Government undertook to set aside $1\frac{1}{2}$ per cent of the loan for the purchase and cancellation of the loan securities, so long as their market price was below the issue price, besides making annual provision to the extent of nearly £500,000 to meet India's liability in respect of the unpaid portion of the war contribution as also provision for the optional payment of an extra Rs. 80 lakhs voted since 1921-2 for an additional depreciation fund for the 5 per cent loan.

CENTRAL GOVERNMENT DEBT AT THE END OF THE YEAR

In crores of rupees

	1939-40	1944-5	1945-6	1946-7	1947-8	1948-9 Revised	1949-50 Budget[1]
(1) Sterling Loans ..	439·10	34·19	33·84	32·84	26·42	24·01	23·49
(2) Rupee Loans ..	450·23	1,212·14	1,492·20	1,529·73	1,517·09	1,478·39	1,496·75
(3) Small Savings[2] ..	135·35	159·18	221·52	273·20	233·10	271·73	309·29
(4) Treasury Bills and Ways and Means Advances ..	54·70	86·70	83·33	79·20	86·84	373·33	378·33
(5) Total Interest-bearing Obligations (including unfunded debt and deposits) ..	1,203·86	1,860·44	2,282·38	2,359·36	2,162·34	2,440·27	2,454·95

But the position so reached was largely the result of accident and the whole question of the redemption of public debt had never been reviewed in a scientific and systematic manner. A well-devised scheme for debt redemption is essential in order to maintain both the external and internal credit of the country unimpaired, so as to facilitate renewals of maturing debt and the raising of such new capital as may be required at reasonable rates of interest. A regular debt redemption scheme was accepted by the Assembly in December 1924 on the initiative of Sir Basil Blackett. In enunciating the principle of the scheme, Sir Basil Blackett suggested that the best way of arriving at a regular programme of debt redemption was to take the gross total of the debt, examine the capital assets held against it and fix the appropriate period within which it is desirable to amortize each category of debt. On this plan, the Finance Member announced a scheme on 9 December 1924, under which, for a period of five years in the first instance, the annual provision for the reduction or avoidance of debt to be charged against annual revenues was fixed at Rs. 4 crores a year plus 1/80th of the excess of the debt outstanding at the end of each year over that outstanding on 31 March 1923, sterling debt being converted into rupees at Rs. 15 per £ for this purpose.[3] As Sir Basil Blackett made it clear, the provision for the sinking funds so proposed would operate not to reduce the net total debt as long as there is a considerable annual programme of new capital expenditure, but to reduce the unproductive portion of it. The

[1] As passed by the Indian Parliament.

[2] Includes since 1944-5 (i) Post Office Cash Certificates, (ii) Savings Bank Deposits, (iii) Defence Savings Certificates, (iv) Defence Savings Bank Deposits and (v) National Savings Certificates.

[3] See *India's Parliament*, vol. X, p. 275.

amount thus provided becomes a contribution out of revenue towards productive capital expenditure. The provision, therefore, is better described as a contribution out of revenues for the reduction or avoidance of debt than as a sinking fund.

With effect from 1930, adequate provision was made for the first time to meet the accruing liability in respect of Cash Certificates, which were henceforward to be regarded as part of the Government's debt.

The Finance Member announced, in his Budget speech for 1930-1, that in view of the close interdependence of the Conventions regarding the Railways (providing for a certain fixed annual contribution to the general revenues, almost the whole of which is applied for the amortization of their capital) with the Convention as regards the debt redemption scheme, it was better to leave the latter provision untouched and to bring it under review at the time of the forthcoming general revision of finances. Accordingly it was decided that, for the time being, provision from the year 1930-1 onwards should be made on the same lines as before, except that the sterling debt should be converted into rupees at Rs. 13⅓ per £ instead of Rs. 15 per £.[1] Since 1933-4 the annual amount provided for the reduction or avoidance of debt was reduced to a lump sum of Rs. 3 crores on the ground that, since 60 per cent of the Government of India debt was attributable to the railways, it would be imposing too heavy a burden on the General Budget to revert to the Sinking Fund arrangements in force prior to 1933-4 before the railways had resumed the practice of making a contribution to the General Revenues. Although this condition has been fulfilled under special conditions in recent years the original debt redemption scheme remains suspended, and annually an appropriation of Rs. 3 crores is made for reduction or avoidance of debt.

The loans raised in India are called rupee loans or rupee debt, as they are subscribed in rupees and the interest and principal are paid in rupees. It must not, however, be supposed that the rupee loans are necessarily internal loans or even held wholly by Indians. The bulk of the rupee debt is held in India, but a certain portion is held by investors who live in England and receive their interest in that country. Again, the rupee debt held in India is divided between Indian and European investors. It has been suggested that all debt, whether rupee or sterling, whether held in India or England, should be considered as external if held by non-Indians, and internal if held by Indians. Judged by this standard, the major portion of our debt was, until recently, external.

§30. **Repatriation of sterling debt.**—A beginning was made in 1937 in repatriating our sterling debt but it had to be temporarily discontinued owing to the slackening of sterling remittances. With the increasingly favourable balance of trade, especially after the beginning of the war, in 1939 large sterling receipts became available in London on account of (i) recoveries from His Majesty's Government for their share of war expenditure incurred by India as well as for large purchases of raw materials and goods paid for in the first instance by the Government of India, (ii) contributions towards the expenditure on defence modernization in

[1] *Budget Statement for* 1930-1, pars. 25-6 and *Financial Secretary's Memorandum for* 1931-2, par. 32.

accordance with the Report of the Chatfield Committee and (iii) receipts for sales of silver in London on behalf of the Government of India. These resources made it possible to reopen the former scheme by which the Reserve Bank was authorized to purchase India sterling non-terminable securities in the open market and to transfer them to the Government of India for cancellation. In their place, additional Rupee Paper of 3½ and 3 per cent non-terminable loans was created in accordance with the requirements of the market. A further scheme of repatriation of sterling was brought into force in February 1940, extending the option of transfer to rupee loans to holders of all India sterling loans and sanctioning the creation of rupee counterparts for six specified dated sterling loans. Under this scheme owners of sterling obligations could voluntarily convert their holdings from the books of the Bank of England into rupee counterparts registered in the books of any one of the Reserve Bank offices in India. Considerable open market purchases were made in London by the Reserve Bank of India and the total so acquired amounted to £ 28½ million on 8 February 1941.

On this date an announcement was made of further operations for the compulsory acquisition and repatriation of India's terminable sterling debt amounting approximately to £ 90 million or Rs. 120 crores in co-operation with the British Government, which came to the help of the Government of India by issuing orders under their special war powers compelling holders resident in the United Kingdom to sell their stocks to them for delivery to the Government of India at market prices prevailing at the time of the order and thus dispensing with the expensive alternative of buying them in a rising market. A similar order was issued by the Government of India affecting holders of sterling stock resident in India. The machinery for financing this repatriation operation may now be briefly explained. There were two stages, first the Government of India bought the sterling from the Reserve Bank, and secondly the Government of India had to obtain rupees to pay for the sterling. The Reserve Bank of India utilized a portion of its large stock of sterling securities and balances in its Issue and Banking Departments, acquired since the commencement of war, for purchasing India's sterling debt.

According to a Press Communique issued by the Government of India on 28 April 1941, the total face value of the outstanding terminable loan on 8 February 1941 was approximately £84 million, and the market value a little over £89 million. Holdings of India sterling stock compulsorily acquired in the United Kingdom and India amounted to £59 million and £11 million respectively, making a total of £70 million in round figures. The balance of about £14 million represented stock held by non-residents outside the United Kingdom and British India. The Government of India had to find rupee finance of the order of Rs. 88 crores for stock of the face value of Rs. 80 crores in round figures. Of this, for the time being, half was paid for by the issue of rupee counterparts to the Reserve Bank and half from balances with the help of temporary ways-and-means advances from the Bank, which were to be gradually liquidated.[1]

The second compulsory scheme was decided upon on 24 December 1941

[1] The final adjustment was effected in June 1941 by the conversion of the rupee counterparts into regular 3 per cent (new) Rupee Loans of the Government of India, the total amount so converted being Rs. 28·56 crores by the end of June 1941. See *Annual Report of the Reserve Bank* (1941), p. 17.

and was followed up by the redemption of 3½ per cent sterling stock during 1942-3. The total debt repatriated between 1 April 1937 and 31 March 1943 was of the face value of £307·26 million and was partially financed by creating rupee counterparts of the value of Rs. 234·97 crores. Stray parcels of Government of India sterling stock and of railway debentures bought and cancelled during 1943-4 amounted to £3 millions financed by Government balances.

With the virtual completion in 1943-4 of the various schemes of repatriation, the debt repaid during 1944-5 related to cancellations of repatriated stocks, not surrendered earlier. In addition (i) the Madras & Southern Mahratta, (2) the South Indian and (3) the Bengal-Nagpur Railways were acquired at a cost of £5·28 million, £1·11 million and £3·60 million respectively. During the year 1945-6, stray lots of the face value of £0·28 million were repatriated at a cost of Rs. 37 lakhs and during 1946-7, stray lots of the face value of £0·76 million were repatriated at a cost of Rs. 1·06 crores.

The table below[1] shows the amounts repatriated and cancelled year by year from 1937-8 to 1945-6 and the particulars of the debt cancelled under the various schemes of repatriation during 1946-7:

AMOUNTS OF STERLING DEBT REPATRIATED SINCE 1937-8

	Face Value (£ million)	Purchase Value		Rupee counterparts created (Rs. crores)
		(£ million)	(Rs. crores)	
1937-8 ..	2·99	3·04	4·05	1·12
1939-40 ..	17·09	16·54	22·05	22·79
1940-1 ..	71·29	75·24	100·32	94·86
1941-2 ..	99·04	92·28	123·04	33·58
1942-3 ..	119·00	120·48	161·67	82·62
1943-4 ..	13·02	12·97	17·29	38·42
1944-5 ..	0·41	0·37	0·49	0·17
1945-6 ..	0·28	0·29	0·37	0·01
1946-7 ..	0·76	0·80	1·06	0·01
1947-8 ..	4·65	5·12	6·83	0·45
Total ..	328·53	327·13	437·17	274·03
1948-9				
1. First compulsory scheme of 8 February 1941 (including special arrangements) ..	0·129	0·136	0·182	0·024
2. Second compulsory scheme of 24 December 1941 (including special arrangements) ..	0·030	0·029	0·038	—
3. Redemption of 3½ per cent sterling stock 1931 or after ..	0·018	0·018	0·024	—
4. Repatriation of railway debenture stocks ..	0·003	0·004	0·005	—
Total	0·180	0·187	0·249	0·024
GRAND TOTAL:	328·71	327·32	437·42	274·05

[1] *Report on Currency and Finance* (1946-7), p. 91.

The substitution of rupee for sterling obligations is a real gain to the country. The liquidation of external obligations means the lessening of strain upon the ultimate cash reserves of the country, i.e. on the holding of gold and other external assets, which tends to manifest itself when, in consequence of world events, the value of overseas trade declines. 'Technically the debtor-creditor position between India and England was undesirably top-heavy. The approach to financial equality, which the redemption accelerates, makes for a healthy monetary position and by lessening India's indebtedness represents the financial complement to her industrial advance.'[1] Financially India's external position is considerably strengthened and this should make it possible for the Reserve Bank to hold a somewhat lower proportion of external assets than previously. Incidentally the conversion of sterling stock eventually into rupee securities is calculated to broaden the market for gilt-edge securities in India and supply the needs of investing institutions.

§31. **Sterling balances.**—India has always held sterling in the United Kingdom as part of her currency reserve. Under the Reserve Bank of India Act not less than 40 per cent of the assets of the Issue Department had to be in the form of gold coin or bullion or sterling securities, subject to the proviso that the amount of gold was to be at least Rs. 40 crores in value. In September 1939 the sterling balances totalled £52 million. On 14 August 1947 the figure was £1,137 million. The chief sources of accumulation were the purchase of stores and other materials from India on behalf of the British Government and the Allied countries for war purposes. The rupees required for financing these purchases were obtained by using the section of the Reserve Bank of India Act which imposed on the Bank the obligation to buy sterling to an unlimited extent. Thus, as the *Eastern Economist* (5 October 1945) remarked: 'A law designed to protect the country against excessive issue of the currency by its own monetary authority became during the war the instrument by which limitless expansion of currency was rendered possible at the instance of the sovereign power.' The British Government paid for its purchases in India in sterling in London which was transferred to the Reserve Bank and the Reserve Bank issued a corresponding value of notes in return. (As we have already seen, this abnormal expansion in currency which was not accompanied by a proportionate increase in production has been mainly responsible for the great rise in Indian prices since 1940.) The sterling balances represent the heavy sacrifice imposed on the Indian people due to the fact that they were compelled to bear not only the cost of India's own defence in a war which she had joined not by her own free decision but by the simple and totally undemocratic decree of the Viceroy, but also to provide the goods and services required for the war-effort of the British and the Allied Governments, suffering in consequence the evils of acute shortages and currency inflation. India's claim to be paid in full is thus very strong and there is much less opposition to it now than there was at first.

An Interim Agreement on India's sterling balances designed to cover the period up to 31 December 1947 was signed in London on 14 August 1947. The main features were as follows:

[1] *Times of India*, 18 February 1941.

(1) The balances of the Reserve Bank of India were to be kept in two accounts. No.1 Account was to be the main operative account and was to contain the multilaterally convertible currency. To this account were to be credited the amounts released from the accumulated balances and all future current earnings.

No. 2 Account was to contain the remainder of the accumulated balances.

(2) A sum of £35 million was to be transferred to the credit of Account No. 1. This amount was intended to meet the estimated deficit in India's balance of payments on current account from 15 July to 31 December 1947.

(3) In addition to this straight release of £35 million, a further amount of £30 million was to be placed to the credit of Account No. 1 as a working balance to be used to meet any temporary deficit in India's available means of payment abroad. For all practical purposes the amount available for use and convertible in any currency was to be £65 million.

In January 1948 this agreement was renewed subject to minor changes, for a further period of six months. As the agreement was to terminate in June 1948, a delegation was sent to London for fresh negotiations, which ended in a new agreement being signed on 9 July 1948, of which the following are the main points:

(i) *United Kingdom stores in India.*—A sum of £100 million (Rs. 133 crores) to be paid in full and final settlement for all the stores and installations taken over on 1 April 1947.

(ii) *Sterling pensions.*—The United Kingdom Government to be paid a sum of £147½ million (Rs. 197 crores) and India to purchase from them a tapering annuity starting with £6,300,000 in 1948 and gradually falling to nothing in 60 years.

(The annual liability is of the order of £6¼ million (Rs. 8 crores). The payment of sterling pensions to be met by the capital payment from the sterling balances.) The liability of the provinces in India is of the order of a little under a million pounds a year (Rs. 1¼ crores) and it was agreed to purchase a similar annuity in regard to these pensions. The payment on this account was to be £20½ million (Rs. 27 crores).

(iii) *Defence expenditure plan.*—The final accounts of the undivided Government of India for 1946-7 showed that a sum of £49 million (Rs. 65 crores) remained due from the United Kingdom, under the plan for the allocation of defence expenditure between India and that country. Certain liabilities, pertaining to the period covered by this plan, still remained to be met, and after allowing for these the final amount was fixed at £65 million (Rs. 73 crores).

(iv) *Release of sterling balances.*—During the period of three years from 1 July 1948, the U.K. was to release a sum of £80 million, in addition to which India was to carry forward an unspent balance in account No. 1 of £80 million out of the previous releases. In other words, the total available foreign exchange for these three years, over and above the current earnings by exports, came to £160 million (Rs. 213 crores).

The total sterling balances were of the order of £1,160 million and the amount

remaining (estimated at £800 million)[1] after payment for the military stores and installations and the purchase of annuities for pensions and the transfer of Pakistan's share to her would be available for meeting the country's requirements of foreign exchange which were not met by current exports.

(v) *Multilateral convertibility.*—In the first year 1948, a sum of £15 million (Rs. 20 crores) was to be made available for the first year, at the end of which the position was to be reviewed.

As stated under (iv) above, India's share of the sterling balances after the deductions for military stores and installations and the capitalization of pensions was £800 million. Deducting from this the amount of £160 million which, according to the agreement, was to be released during the period of three years from 1 July 1948, the balances came to about £640 million. If £200 million were to be regarded as the normal currency reserve of the Reserve Bank of India, the balance of £440 million would be left and the question of its liquidation would arise in July 1951 when the present agreement expires.

The releases agreed to under the agreement of July 1948 were considered as reasonably satisfactory from India's point of view without involving undue strain on the economy of Britain. Almost the whole of the amount released previously had remained unspent (see (iv) above) and apparently this weakened India's case for larger releases under the new agreement.

As regards multi-convertible sterling, in spite of the apparent inadequacy of £15 million during the first year there were certain compensating factors. A recent agreement concluded by the British Government with Switzerland gave India the benefit of paying that country in sterling approximately to the extent of our adverse balance with it during 1947. The same kind of arrangements were made by Britain with France, Sweden and Czechoslovakia. Some of these countries, having highly developed machine-making and engineering industries, were in a position to supply many urgent requirements of India and to that extent India's dependence for essential imports on hard-currency countries like the United States and the consequent drain on her limited dollar resources would be reduced. Britain has also agreed to render all possible aid to India in obtaining supplies of essential commodities such as oil, cotton, and non-ferrous metals, for which payment could be made in sterling.

Financial Relations between the Central and the Provincial Governments

§32. **Financial relations before the Reforms of 1919.**—From 1833 to 1871 all financial powers were in the hands of the Government of India, which controlled the smallest details of Provincial expenditure. The whole of the revenues were paid to the account of the Government of India, and the Provincial Governments only received fixed contributions to meet their expenses. This led to extra-

[1] The post-devaluation foreign trade policy of the Government of India of stimulating exports and restricting imports helped the country to earn and conserve foreign exchange. Thus the first six months of 1950 witnessed an addition to the sterling balances of Rs 7 crores followed by a furthur addition of Rs 8 crores during the next six months, taking the total to Rs 835 crores on 31 December 1950

vagance, rigidity and friction in Provincial finance and uncertainty in Central finance. 'The distribution of the public income degenerated into something like a scramble, in which the most violent had the advantage, with very little attention to reason. As local economy brought no local advantage, the stimulus to avoid waste was reduced to a minimum, and as no local growth of the income led to local means of improvements, the interest in developing the public revenues was also brought down to the lowest level' (Sir John Strachey). This system of 'barren uniformity and pedantic centralization' was found to be thoroughly unsuited to a continental country with great diversity of local conditions. Lord Mayo was impressed with the necessity of some measure of financial decentralization to enlist greater interest and more animated co-operation on the part of the Provincial Governments in developing the public revenues and managing them with all possible economy. He initiated the system of 'Provincial Settlements' in 1871, under which certain heads of expenditure local in character were handed over to the Provinces, such as Police, Education, Roads and Civil Works, Registration, Medicine and Jails. For the management of these departments the Provinces were given, in addition to the departmental receipts, annual fixed lump-sum grants, the deficiency being made good by local taxation if necessary.[1]

Actual experience revealed various defects of this system. It failed to endow the Provinces with adequate revenues. The system did not provide any real motive for economy in the Provinces, as the Provinces were empowered to supplement their income by additional taxation which, under existing arrangements, could only mean an increased burden on the poor.

In 1877, a further step in decentralization was taken by Lord Lytton with the help of his Finance Member, Sir John Strachey. Practically all the remaining heads of expenditure that were Provincial in character, such as Land Revenue, Excise, Stamps, General Administration, Law and Justice, were transferred to the Provinces. In addition to the departmental receipts and the old lump-sum grants, certain heads of revenue such as Excise, Stamps, Law and Justice, were made over to the Provincial Governments. Under this arrangement, the heads of revenue were divided into Central and Provincial. It was found, however, that fixed lump-sum grants were still necessary from year to year and they caused the usual annual bickerings. The Provinces moreover showed no enthusiasm in the collection of revenue in which they were not given a share. Assam and Burma, being backward Provinces, were not admitted to the scheme described above. Under a financial settlement effected in 1879, in addition to wholly Provincial revenues, Burma was given a share of the land revenue and also of the income from forests and the export duty on rice and salt, instead of a fixed assignment of money to meet the Provincial deficit. The same principle of shared or divided revenues was applied to the Province of Assam, which received a share of land revenue. This threefold division of revenues, namely (i) wholly Imperial, (ii) wholly Provincial, and (iii) jointly

[1] Dr Ambedkar divides the stages in the growth of financial decentralization, since Lord Mayo's reforms of 1871, according to the method of supply to the Provincial Governments adopted by the Government of India, namely, (*a*) Budget by Assignments (1871-2 to 1876-7); (*b*) Budget by Assigned Revenues (1877-8 to 1881-2); and (*c*) Budget by Shared Revenues (1882-3 to 1920-1). See B. R. Ambedkar, *Provincial Finance*, part II, chs. iv-vi.

Imperial and Provincial, was later extended to other Provinces by Lord Ripon in 1882.

In 1882 Lord Ripon, with the help of his Finance Member, Major Baring, introduced certain improvements in the Provincial settlements, which he made liable to revision every five years. He abolished the fixed lump-sum grants altogether and revised the allocation of the revenues as follows :

(i) *Imperial heads* :—Opium, Salt, Customs, Commercial Undertakings, etc.,

(ii) *Provincial heads* :—Civil Departments, Provincial Works, and Provincial Rates,

(iii) *Divided heads* :—Excise, Assessed Taxes, Stamps, Forests, Registration, etc.

Instead of giving fixed grants to the Provinces to make up their deficit, a certain percentage of land revenue was made over to them, together with fixed cash assignments under the same head, which thus became an important head of adjustment. Settlements on these lines were made in 1887, 1892, and 1897 without any change of principle, though not without much controversy and Provincial discontent.

To remove the uncertainty and want of continuity of financial policy which characterized the quinquennial Provincial Settlements Lord Curzon made the settlements quasi-permanent in 1904, that is, liable to revision only if there was a substantive change in the original conditions or in the event of emergencies like war and famine.

The settlements were declared to be practically permanent in 1912 by Lord Hardinge's Government, and the allocation decided upon was as follows : On the revenue side the Central Government retained for its use all the revenues which could not be allocated or traced to any Province, these being called the Imperial Heads of Revenue, such as Opium, Railways, Customs, Salt, Mint and Exchange, Posts and Telegraphs, Military receipts, and tributes from Indian States. Of the remainder some were wholly Provincial, like Forests, Excise (in Bombay and Bengal), Registration, and the departmental receipts from such Provincial departments as Education, Law and Justice. Lastly, there was an important class of divided heads of revenue like Land Revenue, Income-tax, Excise (except in Bombay and Bengal), Irrigation and Stamps. Receipts from these were divided between Imperial and Provincial Governments in stated proportions, generally equal, but determined separately for each Province. On the expenditure side a somewhat similar arrangement prevailed, and there was a special arrangement for the sharing of expenditure on famines. The pre-Reform system suffered from the following main defects : (i) The divided heads of revenue in which both the parties were interested were a source of constant interference on the part of the Central Government and hampered Provincial development. (ii) The occasional 'doles' given by the Central Government to the Provinces out of its surpluses had a dislocating influence on Provincial finance. (iii) Serious inter-Provincial financial inequalities were created. (iv) The Provincial Governments had no independent powers of taxation and borrowing. (v) Too detailed a control was exercised over the Provincial budgets and expenditure by the Central

Government. The Provinces, for example, could not budget for a deficit nor could they spend their balances freely.

§33. **Financial relations under the Reforms of 1919.**—After the Reforms the fiscal relations with the Central Government were radically changed. As the new policy of responsible government was to be tried in the Provinces, and as Provincial financial autonomy or financial devolution was recognized to be the keynote of the Reforms, it was deemed necessary to abolish the divided heads of revenue, in order to give effect to the new principle, and the new allocation of revenue and expenditure was as follows : (i) *Imperial Heads of Revenue* :—Opium, Salt, Customs, Income-tax, Railways, Posts and Telegraphs, Military receipts ; (ii) *Provincial Heads of Revenue* :—Land Revenue (including Irrigation), Stamps (judicial and commercial), Registration, Excise and Forests. Mainly as a result of the agitation carried on by the industrial Provinces of Bombay and Bengal against the complete loss of the revenue from income-tax, which was recommended to be an Imperial head of revenue by the Montagu-Chelmsford Report and Meston Committee (see next section), it was finally settled to give to the Provinces a small share of the income-tax revenue, equal to three pies in the tax collection on every additional rupee of the income assessed over and above the amount of income assessed in the datum year 1920-1. As the Taxation Enquiry Committee has pointed out, this rule failed in its object and the whole system of dividing the income-tax on the basis of a datum line was unsound.[1]

§34. **The Meston Award.**—The abolition of divided heads of revenue and the provincialization of some heads like Land Revenue and Stamps resulted in a Central deficit of Rs. 9,83 lakhs, which had to be provided for by a scheme of Provincial contributions to the Central exchequer. A Committee was appointed in 1920 under the chairmanship of Lord Meston to consider this and other allied questions, and its recommendations are known as the Meston Award. The Committee recommended the distribution of this burden by way of initial contributions in 1921-2, which were more or less arbitrarily fixed on the basis of the increased spending power of the Provinces. These were eventually to be supplanted by standard contributions based on the capacity of each Province to pay, judged by such factors as population, income-tax receipts, consumption of salt and textiles, agricultural and industrial wealth, etc.[2] These recommendations with certain modifications suggested by the Joint Parliamentary Committee were embodied in the Devolution Rules issued under the Government of India Act, 1919.

§35. **Abolition of Provincial contributions.**—The Meston Award did not please anybody and caused much Provincial discontent. For, while industrial Provinces like Bombay and Bengal could never reconcile themselves to the virtual loss of the income-tax revenue, agricultural Provinces like Madras, the Punjab and the United Provinces resented what they considered their excessive initial contributions. The contributions were felt to be peculiarly burdensome when the Provincial Governments were faced with a series of heavy deficits in place of the comfortable surpluses which the Meston Committee had envisaged. The revenues

[1] *Taxation Enquiry Committee Report*, par. 529.

[2] See *Report of the Financial Relations (Meston) Committee*, pars. 17 and 28, and *Simon Commission Report*, vol. I, par. 399.

assigned to them, such as land revenue, were inelastic and inadequate to meet occasional contingencies or even the expenses of normal development. There was thus an unceasing clamour for the abolition of the contributions. The gradual improvement in the finances of the Central Government made the extension of some relief possible in 1925-6 and again in 1926-7. In 1927-8, the entire amount of the outstanding contributions was remitted and finally relinquished in 1928-9.

§36. **Problem of federal finance in India.**—The final extinction of the Provincial contributions, however, did not end all controversy regarding the division of revenue between the Central and Provincial Governments. The main grievance of the Provinces, especially of the industrial Provinces like Bombay and Bengal, still remained, and this was that although its expenditure was comparatively stationary, consisting mainly of the cost of the army and the interest on the public debt, the Central Government had taken for itself sources of revenue like income-tax and customs, which were expanding or were capable of expansion, and left for the Provinces inelastic and stagnant sources like land revenue and excise, although the needs of the Provincial Governments were rapidly expanding. The land revenue was already too heavy in some places and was in any case fixed for long terms. Moreover there was great disinclination on the part of the people to submit to additional increases. The excise revenue must decline, with the introduction of prohibition. The forest revenue required liberal capital outlay before it could be appreciably expanded. Stamps offered the only source of revenue which held out a promise of probable increase. The Provinces were responsible for nation-building departments such as education, medical relief and agriculture, on which heavy outlay was essential. Famine expenditure had also been put on the shoulders of the Provincial Governments. The distribution of surplus revenue assigned to the Provinces under the Reforms was determined in a haphazard manner and bore no relation to the needs of the Provinces or to the total taxation derived from them, and this haphazard arrangement was founded upon the academic insistence on the theory of complete federal separation which has not been adopted in any other federal Government in the world. The varying importance of the principal sources of revenue in the different Provinces, their unequal expansion in recent years, and lastly, the abolition of the contributions, which at first modified the effect of the new allocation of revenue, all served to emphasize Provincial inequalities. Th fundamental defect of the system was that, while it professed to follow the theoretical ideal of federal finance, in practice it left inadequate resources to the Provincial Governments which, unlike the units of a federal state, did not possess full powers to determine the scale and nature of the expenditure of the Central Government. What was even more unsatisfactory was that the Government of India Act of 1919 left the residuary powers of taxation in the hands of the Central Government. While the system gave a bare minimum to the more industrialized and commercial Provinces from which the Central Government collected large amounts of income-tax and customs, it yielded a substantial surplus to the agricultural Provinces which produced and retained for themselves a large amount of land revenue. The Provinces benefited in a very unequal manner from the new allocation of revenues, which was arrived at without any attempt to establish an objective standard of fairness. Indeed, as a result of the division of

resources in 1920, all the Provinces received increased spending power. The benefit, however, was very unequally felt, and the abolition of the contributions accentuated the disparity in Provincial resources. The position when the Simon Commission reported (1930), however, was that, while all Provinces were faced with stagnation of revenues, future requirements everywhere were almost unlimited.[1]

Besides arming the Provinces with adequate spending power, without which Provincial autonomy was a meaningless phrase, the Indian financial problem was largely one of harmonizing the distribution of functions with the allocation of the sources of revenue to the Provinces and the Centre respectively. The sound principle is that sources of revenue which, from the administrative point of view, fall naturally within the sphere of the Provincial Governments should harmonize so far as their yield and elasticity are concerned with the functions assigned to these Governments, while those which are naturally Central sources should accord with the functions of the Central Government. The arrangements under the Meston Award were most defective from this point of view.[2]

§37. Division of financial resources between the Centre and Provinces under the Constitution of 1935.[3]—The Government of India Act provided that while taxes and duties might be levied and collected by one authority, the proceeds might be allocated wholly or in part to others.

The Federal Legislative list comprised the following subjects: Duties of customs, including export duties; duties of excise on tobacco and other goods manufactured or produced in India except (i) alcoholic liquors for human consumption; (ii) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs; (iii) medicinal and toilet preparations containing alcohol or any substance included in (ii); Corporation tax; salt; taxes on income other than agricultural income; taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies; duties in respect of succession to property other than agricultural land; the rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts; terminal taxes on goods and passengers carried by railway or air; taxes on railway fares and freights.

The Provincial Legislative list included the following: Land revenue, including the assessment and collection of revenue; duties of excise on the following goods manufactured or produced in the Province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India: (i) alcoholic liquors for human consumption; (ii) opium, Indian hemp and other narcotic drugs and narcotics; non-narcotic drugs; (iii) medicinal and toilet preparations containing alcohol or any substance included in (ii); taxes on agricultural income; taxes on lands and buildings, hearths and windows; duties in respect of succession to agricultural land; taxes on mineral rights subject to any limita-

[1] *Simon Commission Report*, vol. II, pars. 260-1 and 263.

[2] *Simon Commission Report*, vol. II, par. 240.

[3] The financial provisions of the Government of India Act are contained in Sections 137-44 of that Act.

tions imposed by any Act of the Federal Legislature relating to mineral development; capitation taxes; taxes on professions, trades, callings and employments; taxes on animals and boats; taxes on the sale of goods and advertisements; cesses on the entry of goods into a local area; taxes on luxuries, including taxes on entertainments, amusements, betting and gambling; the rates of stamp duty in respect of documents other than those specified in the provisions of the Federal Legislative List with regard to rates of stamp duty; dues on passengers and goods carried on inland waterways; tolls; fees in respect of any of the matters in this list, but not including fees taken in any Court.

§38. **Financial inquiry by Sir Otto Niemeyer.**—The central recommendation made in the report (1936) by Sir Otto Niemeyer, who was appointed by the Secretary of State to conduct the financial inquiry contemplated under sections 138, 140-2 of the Government of India Act of 1935, related to the assignment of a fifty per cent share of the income-tax to the Provinces by the Centre. Sir Otto calculated the income-tax to yield Rs. 12 crores a year. Half of this (Rs. 6 crores), assignable to the Provinces, was to be retained by the Centre for the first five years, during which the Centre should consolidate its position. In the course of the next five years, by six equal steps beginning from the sixth year from the introduction of provincial autonomy, but subject to Section 138(2) of the Government of India Act (1935), this revenue was to be made available to the Provinces gradually, so that after ten years the Provinces would be in the enjoyment of their full share of the income-tax. The income-tax was not to be thus relinquished, however, so long as the portion of the distributable sum remaining with the Centre together with any contribution from Railways aggregated to less than Rs. 13 crores. (See, however, §43 below.)

The percentage division recommended for distribution among the Provinces was as follows; Madras 15, Bombay 20, Bengal 20, U.P. 15, Punjab 8, Bihar 10, C.P. 5, Assam 2, N-W.F. Province 1, Orissa 2, Sind 2.

§39. **Assistance to Provinces.**—Sir Otto Niemeyer proposed immediate assistance from the beginning of provincial autonomy to certain Provinces, partly in the form of cash subventions, partly in the form of cancellation of the net (i.e. after offsetting certain balances) debt incurred prior to 1 April 1936, and partly in the form of the distribution of a further 12½ per cent of the jute tax. In the cases of Bengal, Bihar, Assam, the North-West Frontier Province and Orissa, the entire net debt was cancelled, and in the case of the Central Provinces, all pre-1936 deficit debt plus approximately two crores of pre-1921 debt.

Annual cash subventions were as follows: United Provinces 25 lakhs for 5 years only; Assam 30 lakhs; Orissa 40 lakhs; North-West Frontier Province 100 lakhs subject to reconsideration after 5 years; Sind 105 lakhs to be reduced by stages after 10 years.

The total approximate annual relief in lakhs aimed at by Sir Otto Niemeyer was as follows: Bengal 75; Bihar 25; Central Provinces 15; Assam 45; North-West Frontier Province 110; Orissa 50; Sind 105; United Provinces 25. The extra recurrent cost to the Centre was Rs. 1,92 lakhs.

Orissa was to get a further non-recurrent grant of Rs. 19 lakhs and Sind of Rs. 5 lakhs.

The percentage division of the distributable portion of the income-tax between the Provinces was to be as follows:

Madras 15; Bombay 20; Bengal 20; United Provinces 15; the Punjab 8; Bihar 10; Central Provinces 5; Assam 2; North-West Frontier Province 1; Orissa 2; and Sind 2.

Sir Otto Niemeyer stated that substantial justice would be done by fixing the scale of distribution partly on residence and partly on population, paying to neither factor a rigidly pedantic deference, for which the actual data provide insufficient justification.

§40. **Principles of settlement.**—The following are salient extracts from the Report: 'Throughout the discussions leading up to the Government of India Act, it has been recognized that at the inauguration of provincial autonomy, each of the Provinces should be so equipped as to enjoy a reasonable prospect of maintaining financial equilibrium and, in particular, that the chronic state of deficit into which some of them had fallen should be brought to an end. My first object has accordingly been to examine the present and prospective financial position of the Provinces and to determine the extent to which special assistance would be needed in order to achieve the above aim. Next, it is necessary to consider how far the Central Government is in a position to render such assistance without jeopardizing its own solvency. Finally, I have had to look further into the future and to suggest to what extent and when it may be possible for the Centre to place additional resources at the disposal of the Provinces out of the proceeds of the taxes on income.

'From the Provincial point of view, the desirability of attaining this final result is undeniable and the only question (though in itself a difficult question) is to determine an equitable basis of distribution. From the Central point of view, on the other hand, it is clear that the financial stability and credit of India as a whole must remain the paramount consideration.'

'The claim of the jute-producing Provinces to the whole or part of the jute export duty has already been recognized to the extent of 50 per cent by the Government of India Act. It will, however, be convenient that part of the assistance I contemplate should take the form of an increase in this figure and therefore I recommend that the percentage should be increased under Section 140 (2) of the Act to 62½ on the estimated gross yield of the duty in 1936-7 at 380 lakhs. This increase of 12½ per cent would mean in round figures the following additions to the resources of the Provinces concerned at a corresponding cost to the Central Government: Bengal 42 lakhs; Bihar 2½ lakhs; Assam 2¼ lakhs; and Orissa rather over ¼ lakh.'

The Government of India accepted *in toto* Sir Otto Niemeyer's conclusions and proposed 1 April 1937 as the date for the commencement of provincial autonomy. Accordingly Orders-in-Council were issued on 27 May 1936, relating to the distribution of the revenues and the commencement of provincial autonomy.

§41. **Provincial grievances.**—As was to be expected, a number of the Provinces were dissatisfied and complained of unfair treatment. Thus Orissa felt aggrieved that whereas the subvention in its case was only Rs. 50 lakhs, it was Rs. 105 lakhs in the case of Sind. It was also complained that since the distribution of benefits had been governed by considerations of the actual needs of every Province rather

than its deserts, the assignment of revenues to the Provinces was arbitrary and unjust. Those Provinces which had regulated their finances with economy and ability had come off worse than the spendthrift and incompetent Provinces. Bombay, for example, was aggrieved because due regard had not been paid to the years of painful thrift she had been forced to practise as a result of the inequitable Meston Award. She based her claim for a larger share of the income-tax on the additional ground that more than 25 per cent of the income-tax was realized in Bombay, and Bombay had to provide for many costly services for the benefit of her industrial population. Bombay further deplored that the distribution of the income-tax relief had been made entirely dependent upon the successful running of railways, and pressed for the cancellation of the fictitious debt created in respect of unproductive irrigation works, financed from revenue and not from loans. It was also argued on her behalf that if Bengal was to benefit from the jute export duty, she ought to benefit from the cotton duties. Similarly Madras felt she was entitled to more because, e.g., even on a population basis she should have got something like 24 per cent of the income-tax instead of the 20 per cent recommended. The Madras Government contrasted Provinces like Bengal which had taken least care in balancing their budgets with themselves, and complained that Bombay got too big a share of the income-tax. Bihar put in its claim as the poorest Province and wished the basis of distribution had been a population one. The Punjab complained that too much had been made of the relief secured by her through the separation of the North-West Frontier Province many years ago and that the gratuitous assumption had been made that if the Frontier Province had continued as a division of the Punjab, it would still have remained as a serious burden to the parent Province. The Punjab feared that, under the Niemeyer recommendations, its receipts from the Centre would be less than they were in 1936 by about Rs. 5 lakhs per year. The United Provinces cast envious eyes at 'the big slices given to Bengal and Bombay' and urged that it ought to get more help from the Centre as well, at the expense of the industrial Provinces.

Some of the arguments on which the Provinces based their claims were theoretically unsound. For example, in dealing with the supposed rights to income-tax in relation to population or place of origin and with the question of the jute export duties, the Niemeyer Report hinted at the theoretical weakness of some of the usual arguments advanced in these connexions. The main point was whether, so long as the partners in the new political experiment were assured of solid advantages from the Federation, it was wise on their part to insist on meticulous equality or strict distributive justice. Some of the Provinces were no doubt guilty of improvidence and extravagance. Nevertheless all had to be made to start even as far as possible, and ideas of retributive justice were wholly out of place. Some of the Provincial grievances were well-founded and remediable. But it was almost impossible to make out an unanswerable case for revision. It is so easy to meet one set of cliches by another equally respectable! One obvious fact to be remembered was that to give more to one party meant giving less to the others, that is the other Provinces or the Centre, and the need of the latter might be more urgent or it might be for the common interests of the nation that it should be adequately met.

§42. **Central needs.**—It is most important that the Provinces should be armed

with adequate spending power for the service of the nation-building departments and it is perfectly true that the needs of the Central Government are comparatively speaking stationary and its resources may also be stationary. At the same time Sir Otto Niemeyer was right in insisting upon the stability and adequacy of Central finances as a fundamental necessity. The Centre must have enough money for its essential all-India purposes such as maintaining the credit of the country, defending the country from external aggression and internal commotions. It was also urged that without complete assurance of Central solvency the Indian States would be averse to joining the Federation, that under the new regime the Central Government would be required to incur a certain amount of extra expenditure, e.g. in connexion with the establishment of the Federal Court, that some of its resources were no longer so reliable as they used to be,[1] and lastly that although relatively to the Units its functions would always be narrow, they were likely to be wider in an absolute sense owing to the closer contact with the Provinces which improved communications have made possible and the modern bias in favour of state intervention and central direction. As Sir James Grigg pointed out in his 1938 Budget Statement, the Central Government had relinquished more than Rs. 20 crores of revenue to the Provinces since the war of 1914-18. Moreover in following a protective policy to the extent that had been done the Central Government had not found it easy to make up losses due to reduced import duty receipts.

The success of Sir Otto's scheme, especially that part of it which was concerned with the sharing of the income-tax proceeds between the Centre and the Provinces, depended on the satisfactory working of the railways. The Provincial Governments were in their own interests required to co-operate with the Government of India in restoring the prosperity of railways and making them once more substantial contributors to the general revenues. This involved the regulation of the Provincial road policy so that the roads should assist instead of competing with the railways. It also involved a 'thoroughgoing overhaul of railway expenditure' on the part of the Central Government and a proper co-ordination of the different forms of transport. The realization of the Railway surplus in 1937-8 together with the suspension of railway liabilities and the improved revenue position of the Central Government enabled the assignment of income-tax to the Provinces under the Niemeyer Award to be begun with effect from the financial year 1937-8. On the basis of the revised estimates the amounts payable to the Provinces were as follows: Rs. 1,38 lakhs in 1937-8; Rs. 1,50 lakhs in 1938-9; Rs. 2,79 lakhs in 1939-40; and Rs. 3,73 lakhs in 1940-1.

§43. **Alteration in the Niemeyer formula for assignment of Provincial shares of income-tax.**—In February 1940 the Niemeyer formula for the assignment of their share of the income-tax to the Provinces was amended by Parliament. Under the amended Order-in-Council (which came into effect from 1 April 1939), the Railway contribution was altogether excluded from Central calculation of the sum available for the Provinces, and the Central share of the divisible pool was fixed at the average of the last three years, namely Rs. 4½ crores, for each of the

[1] For example, customs were expected to yield less because of the policy of protection, and the adverse effects of the war on the import trade, and the railways were an uncertain factor.

than its deserts, the assignment of revenues to the Provinces was arbitrary and unjust. Those Provinces which had regulated their finances with economy and ability had come off worse than the spendthrift and incompetent Provinces. Bombay, for example, was aggrieved because due regard had not been paid to the years of painful thrift she had been forced to practise as a result of the inequitable Meston Award. She based her claim for a larger share of the income-tax on the additional ground that more than 25 per cent of the income-tax was realized in Bombay, and Bombay had to provide for many costly services for the benefit of her industrial population. Bombay further deplored that the distribution of the income-tax relief had been made entirely dependent upon the successful running of railways, and pressed for the cancellation of the fictitious debt created in respect of unproductive irrigation works, financed from revenue and not from loans. It was also argued on her behalf that if Bengal was to benefit from the jute export duty, she ought to benefit from the cotton duties. Similarly Madras felt she was entitled to more because, e.g., even on a population basis she should have got something like 24 per cent of the income-tax instead of the 20 per cent recommended. The Madras Government contrasted Provinces like Bengal which had taken least care in balancing their budgets with themselves, and complained that Bombay got too big a share of the income-tax. Bihar put in its claim as the poorest Province and wished the basis of distribution had been a population one. The Punjab complained that too much had been made of the relief secured by her through the separation of the North-West Frontier Province many years ago and that the gratuitous assumption had been made that if the Frontier Province had continued as a division of the Punjab, it would still have remained as a serious burden to the parent Province. The Punjab feared that, under the Niemeyer recommendations, its receipts from the Centre would be less than they were in 1936 by about Rs. 5 lakhs per year. The United Provinces cast envious eyes at 'the big slices given to Bengal and Bombay' and urged that it ought to get more help from the Centre as well, at the expense of the industrial Provinces.

Some of the arguments on which the Provinces based their claims were theoretically unsound. For example, in dealing with the supposed rights to income-tax in relation to population or place of origin and with the question of the jute export duties, the Niemeyer Report hinted at the theoretical weakness of some of the usual arguments advanced in these connexions. The main point was whether, so long as the partners in the new political experiment were assured of solid advantages from the Federation, it was wise on their part to insist on meticulous equality or strict distributive justice. Some of the Provinces were no doubt guilty of improvidence and extravagance. Nevertheless all had to be made to start even as far as possible, and ideas of retributive justice were wholly out of place. Some of the Provincial grievances were well-founded and remediable. But it was almost impossible to make out an unanswerable case for revision. It is so easy to meet one set of cliches by another equally respectable! One obvious fact to be remembered was that to give more to one party meant giving less to the others, that is the other Provinces or the Centre, and the need of the latter might be more urgent or it might be for the common interests of the nation that it should be adequately met.

§42. **Central needs.**—It is most important that the Provinces should be armed

with adequate spending power for the service of the nation-building departments and it is perfectly true that the needs of the Central Government are comparatively speaking stationary and its resources may also be stationary. At the same time Sir Otto Niemeyer was right in insisting upon the stability and adequacy of Central finances as a fundamental necessity. The Centre must have enough money for its essential all-India purposes such as maintaining the credit of the country, defending the country from external aggression and internal commotions. It was also urged that without complete assurance of Central solvency the Indian States would be averse to joining the Federation, that under the new regime the Central Government would be required to incur a certain amount of extra expenditure, e.g. in connexion with the establishment of the Federal Court, that some of its resources were no longer so reliable as they used to be,[1] and lastly that although relatively to the Units its functions would always be narrow, they were likely to be wider in an absolute sense owing to the closer contact with the Provinces which improved communications have made possible and the modern bias in favour of state intervention and central direction. As Sir James Grigg pointed out in his 1938 Budget Statement, the Central Government had relinquished more than Rs. 20 crores of revenue to the Provinces since the war of 1914-18. Moreover in following a protective policy to the extent that had been done the Central Government had not found it easy to make up losses due to reduced import duty receipts.

The success of Sir Otto's scheme, especially that part of it which was concerned with the sharing of the income-tax proceeds between the Centre and the Provinces, depended on the satisfactory working of the railways. The Provincial Governments were in their own interests required to co-operate with the Government of India in restoring the prosperity of railways and making them once more substantial contributors to the general revenues. This involved the regulation of the Provincial road policy so that the roads should assist instead of competing with the railways. It also involved a 'thoroughgoing overhaul of railway expenditure' on the part of the Central Government and a proper co-ordination of the different forms of transport. The realization of the Railway surplus in 1937-8 together with the suspension of railway liabilities and the improved revenue position of the Central Government enabled the assignment of income-tax to the Provinces under the Niemeyer Award to be begun with effect from the financial year 1937-8. On the basis of the revised estimates the amounts payable to the Provinces were as follows: Rs. 1,38 lakhs in 1937-8; Rs. 1,50 lakhs in 1938-9; Rs. 2,79 lakhs in 1939-40; and Rs. 3,73 lakhs in 1940-1.

§43. **Alteration in the Niemeyer formula for assignment of Provincial shares of income-tax.**—In February 1940 the Niemeyer formula for the assignment of their share of the income-tax to the Provinces was amended by Parliament. Under the amended Order-in-Council (which came into effect from 1 April 1939), the Railway contribution was altogether excluded from Central calculation of the sum available for the Provinces, and the Central share of the divisible pool was fixed at the average of the last three years, namely Rs. 4½ crores, for each of the

[1] For example, customs were expected to yield less because of the policy of protection, and the adverse effects of the war on the import trade, and the railways were an uncertain factor.

three years 1939-40, 1940-1 and 1941-2; the balance being distributed to the Provinces. The same arrangement was continued for 1942-3, 1943-4, and 1944-5 under subsequent amendments. The amount to be retained by the Centre from the Provincial share was reduced to Rs. 3·75 crores in 1945-6, and to Rs. 3 crores in 1947-8. The justification for this alteration was the complete change in the financial situation brought about by the war, which entailed heavy expenditure by the Central Government and adversely affected the customs revenue. It would therefore have been anomalous if the increased income-tax revenue, largely derived from the same war conditions, had entirely accrued to the Provinces as it would have done under the old formula, which also gave the Provinces the whole benefit from the increase in the Railway surplus, even though it was the result of increased rates and fares resorted to by the Central Government for its own needs and the increase in traffic due to war conditions. It was, however, presumed that the Provincial share of income-tax was not likely to be reduced under the new arrangement, as the Provinces would get the benefit of the improvement in the income-tax revenue under the new Income-Tax Act (1939) and that portion of the Excess Profits Tax which was not classed as Corporation Tax.

§44. **The Deshmukh Award.**—As a result of the partition, portions of the former provinces of Bengal, Punjab and Assam came to be included in Pakistan. It therefore became necessary to determine the shares of revenue allocation to be taken away from these Provinces in respect of the portions which had now gone to Pakistan and to reallocate them among the Indian Union Provinces (now called States). The question of determining grants payable under Article 273 of the new Constitution to the Provinces previously sharing the jute export duty, in lieu of their shares in that duty, had also to be settled.[1] Both these were referred for inquiry and recommendations to Mr Chintaman D. Deshmukh in November 1949.[2] Mr Deshmukh's award, which was communicated to the Government of India towards the end of January 1950, took effect from 1 April 1950.

The percentage distribution of the divisible portion of the income-tax under the Niemeyer Award has been given above in §39. In estimating the lapsed percentage shares Mr Deshmukh visualized the problem as one of finding out as nearly as possible the percentages that might have been allotted by Niemeyer to the parts of Provinces now in Pakistan, had they been in existence as separate Provinces at the time, in relation to the shares he allocated to Provinces of comparable dimensions and fiscal status. The reallocation of these lapsed percentages has resulted in the following new percentages: Bombay 21, Madras 17·5, West Bengal 13·5, U.P. 18, C.P. 6; East Punjab 5·5, Bihar 12·5, Orissa 3, Assam 3.

The grants-in-aid in respect of the jute export duty according to the Deshmukh Award are as follows in lakhs of rupees: West Bengal 105; Assam 40, Bihar 35, Orissa 5.

[1] After partition, the share of the Provinces concerned in the jute export duty came to be reduced from 62½ per cent to 20 per cent as the bulk of the jute-growing area is now under Pakistan. Under the new Constitution the jute export duty as such is not divisible. But the jute-growing Provinces are to enjoy a temporary grant for 10 years.

[2] Formerly Governor of the Reserve Bank of India and now (1950) Minister of Finance to the Government of India.

The Deshmukh Award is to remain in force until the Finance Commission, which under the new Constitution is to be appointed within two years of the inauguration of the Constitution, reviews the whole question again.

§45. **Recent Provincial finance.**—The expenditure in the Provinces, like Central expenditure, has risen steadily. The rise was especially noticeable between 1923-4 and 1928-9, being no less than 22 per cent as compared with an increase of only 4 per cent in the revenue. The continued increaso in expenditure was made possible in some cases by the remission of Provincial contributions. Between 1930-1 and 1934-5, while Provincial revenues received a setback owing to the severe economic depression, there was no corresponding reduction in expenditure, and a succession of deficit years was inevitable. The position improved in the next few years, at any rate in some of the Provinces.

After the introduction of Provincial Autonomy both the revenue and expenditure of the Provincial Governments increased considerably. The Provinces benefited by receipts from the Central Government on account of taxes on income as a result of the Niemeyer Award, the annual cash subventions to some Provinces, and the increased share in the jute export duty in favour of the jute-growing provinces under the same award. As already pointed out, new taxes, such as Sales Taxes, Employment Taxes, Urban Immoveable Property Taxes (as in Bombay), etc., were resorted to by the Provinces partly to find additional revenue for the expansion of educational and generally nation-building departments, and partly to meet the gap in the revenue caused by the introduction of partial or total prohibition.

The following table presents the consolidated figures of revenue, expenditure and surpluses or deficits of the States of the Indian Union, excluding the East Punjab and West Bengal.

In lakhs of rupees

								Revised	Budget
	1939-40	1941-2	1942-3	1943-4	1944-5	1945-6	1946-7	1947-8	1948-9	1949-50
Revenue ..	58,70	70,11	82,40	105,90	134,14	148,86	169,78	176,59	212,93	223,57
Expenditure ..	57,53	66,74	77,43	101,98	128,00	144,87	162,17	171,60	214,82	219,90
Surplus (+) or deficit(−)	+1,17	+3,37	+4,97	+3,92	+6,14	+3,99	+7,61	+4,99	−1,89	+3,67

The table shows a successive rise in revenue as well as expenditure every year following the outbreak of the war. The increase in revenue was due to rise in agricultural prices, increasing utilization of Provincial resources such as forests, additional or new taxation, anti-inflationary in character, in most of the Provinces, and the substantial rise from year to year in the Provincial share in the Centre's divisible pool of income-tax.

The increase under expenditure was due to the additional financial burden entailed in respect of police and civil defence measures, dearness and other allowances, outlays on food, supply and distribution schemes, allocation of funds by some Provinces towards substantial reductions in their debts to the Centre, enhanced expenditure on nation-building activities and the earmarking of funds by most of the Provinces for post-war reconstruction.

Another feature revealed by the table is the surplus in revenues during each of the war years,[1] in striking contrast with the large deficits in the Central Government's budgets caused mainly by the heavy defence expenditure.

The following table shows the subventions and other payments made by the Central Government to Provinces since 1937-8 in terms of the Government of India (Distribution of Revenues) Order of 1936 as amended in February 1940 and subsequently. The table also includes the special grants made by the Centre.

ALLOCATION OF TAX PROCEEDS, SUBVENTIONS AND GRANT-IN-AID TO PROVINCES.[2]

In crores of rupees

Year	Income-tax	Jute duty	Subventions	Other Grants-in-aid	Total
1937-8	1·25	2·65	3·12	—	7·02
1938-9	1·50	2·51	3·03	—	7·04
1939-40	2·79	2·56	3·03	—	8·38
1940-1	4·16	1·85	3·03	—	9·04
1941-2	7·39	1·95	3·03	—	12·37
1942-3	10·90	1·40	2·75	0·01	15·06
1943-4	19·50	1·38	2·75	3·00	26·63
1944-5	26·56	1·49	1·70	7·00	36·75
1945-6	28·75	1·57	1·70	8·00	40·02
1947-8	29·74	1·28	0·44	1·40	32·86
1949-50 (Budget)	40·65	1·46	0·70	2·25	45·06

The feature common to almost all the Provinces is the great increase in expenditure in recent years on security services necessitated by the communal disturbances consequent on the partition and the larger provision for social services. Other factors which have gone to swell the expenditure are the revised pay scales of Government servants, subsidies for food, literacy programmes, industrial development and above all the relief and rehabilitation of refugees. As excise revenue is dwindling as a result of prohibition, the Provinces are increasingly resorting to sales taxation by increasing its rate as well as its scope.

The taxation of agricultural incomes is becoming increasingly important in the Provincial tax structure. Several Provinces including West Bengal, U.P., Bihar, Assam and Orissa have already levied this tax and others are thinking of introducing it.

§46. Provincial reconstruction finances.—When the reconstruction schemes were first discussed in 1946 at a conference of Provincial Ministers in charge of reconstruction, it was expected that half the reconstruction finances would be covered by revenue surpluses. The Provinces were also promised more than half the anticipated Central surpluses. But these anticipated Provincial and Central surpluses failed to materialize. The reserves which had been accumulated during war-time out of revenue surpluses to provide part of the finance for reconstruction had to be drawn upon to cover revenue deficits. There are no such reserve funds for Orissa, the East Punjab and West Bengal. The outstanding balances of the

[1] Bengal, which had heavy deficits particularly in 1943-4 and 1944-5, was a notable exception.

[2] Figures before 1947-8 relate to undivided India. Figures for 1947-8 relate to 7½ months from 15 August 1947 to 31 March 1948.

other Provinces in the Post-War Reconstruction Funds at the end of 1949-50 were as given below:

1949-50 (Budget) *In crores of rupees*

Madras	.. 30·35	C.P.	.. 8·12
Bombay	.. 17·26	Bihar	.. 12·50
U.P.	.. 12·76	Assam	.. 1·02

In November 1948, after a review of all development schemes, an order of priorities was laid down, under which schemes productive of food and other essential consumers' goods, especially those likely to yield quick results, were to be given high priority. The Centre's promised contribution was originally Rs. 270 crores. After the partition, for the four years 1948-9 to 1951-2, the outstanding balance that remained to be distributed was about Rs. 175 crores. In the case of West Bengal, East Punjab, Assam and Orissa, the whole of the expenditure on approved schemes subject to a maximum was met by the Centre in 1948-9 and 1949-50. In the case of other Provinces, Central grants were contingent on the Provinces themselves spending at least an equal amount. According to the budget for 1949-50, the total Central grants to the Provinces amounted to Rs. 25·39 crores besides loans amounting to Rs. 47·20 crores.

Railway Finance

§47. Financial results of the railways under the Separation Convention.— The financial results of the working of railways under the Separation Convention of 1924 can be summarized as follows: Taking the period 1924-5 to 1935-6 it is found that the first six years were years of prosperity, and the last six, years of adversity. Taking the period as a whole the total surplus revenue earned in the first six years amounted to Rs. 52,64 lakhs, whilst in the second six years the deficiency amounted to Rs. 41,63 lakhs. During this long period of varying fortune there was a net surplus of Rs. 11,01 lakhs or rather less than one crore of rupees per annum after meeting working expenses, providing for depreciation and paying interest in full on borrowed capital. The total contributions to the general revenues during the period of prosperity, 1924-5 to 1929-30, amounted to Rs. 42 crores, or an average of Rs. 3 crores for the whole period dating from the Separation Convention. During the same period a balance of Rs. 41½ crores was accumulated in the Depreciation Fund.

The year 1930-1 ushered in an era of deficits which were mainly the result of the world depression and the drop in commodity prices, dwindling of wheat exports, disturbed political conditions, damage caused by floods and earthquakes, acute road competition,[1] intensified river and sea competition, and increase in working expenses due to increase in wages, etc. The tariff policy of practically all countries in the world, many of which were in the past our best customers, also adversely affected the earning capacity of the railways.

Owing to these successive deficits the railways failed to make any contri-

[1] The Wedgwood Inquiry Committee (1937) estimate the loss of railway traffic due to road competition in the neighbourhood of Rs. 4½ crores per annum. *Report of the Indian Railway Inquiry Committee*, par. 169.

bution to general revenues after 1931-2. The accumulated arrears of contribution due under the Separation Convention during the years from 1931-2 to 1936-7 amounted to Rs. 30·74 crores. This figure rose to Rs. 36¾ crores at the end of the year 1939-40. During the same period the railways not only practically depleted their general reserves but also borrowed from the Depreciation Fund to the extent of Rs. 31·34 crores, in order to meet their obligations regarding interest charges. It was utterly impossible to repay so large a liability of nearly Rs. 62 crores out of future surpluses within a measurable distance of time. Meanwhile, with the inauguration of Provincial Autonomy under the new Constitution, claims for increased resources were becoming insistent. But as, under the existing Separation Convention, loans from the Depreciation Fund were a first charge on future surpluses and there was also thereafter the undischarged liability to general revenues, the latter would have had to wait long before they were entitled to receive any contribution from the railways. The escape from this dilemma was found in a moratorium of three years from 1937 [1] for the repayment of the liabilities. The moratorium made possible the appropriation of the surplus of net railway receipts over the interest charges which had begun to show itself from the year 1936-7, for immediately resuming the contribution to general revenues without making good the heavy liabilities of nearly Rs. 62 crores. This in its turn enabled the Central Government to make a limited assignment of the income-tax to the Provinces in the years 1937-8, 1938-9 and 1939-40 under the Niemeyer Award.

After six years of deficits the railways at last began to pay their way and show a surplus of net receipts over the interest charges and appropriations to the Depreciation Fund. This improvement became evident during 1936-7 partly owing to the recovery of trade and prices and partly owing to retrenchment in expenditure. The recovery, however, contained an unstable element, in so far as it was due to the world's rearmament programme. The surplus of Rs.1¼ crores for 1936-7 was utilized to repay part of the debt to the Depreciation Fund. Similarly, the surplus of Rs. 2¾ crores in 1937-8 was credited to the general revenues under the moratorium resolution (1937) referred to above. In the year 1938-9, the surplus realized was Rs. 1·37 crores only but in 1939-40 it rose to Rs. 4·33 crores. The clouded international situation during the earlier part of the year had contributed to a considerable holding of stocks in certain commodities and there was a fall both in passenger and goods traffic earnings. After the declaration of war, however, there was a marked change especially in the goods traffic earnings, and later in passenger earnings with an initial improvement in the economic condition of the people. The transfer of traffic from sea to rail routes further assisted the financial position of the railways as did the increase in fares and rates introduced from 1 March 1940.

The Accounts for 1945-6 showed a surplus of Rs. 38·20 crores. In accordance with the decision taken in 1943 to fix the contribution to the general revenues at Rs. 32 crores in each of the two years 1944-5 and 1945-6, Rs. 32 crores went to the general revenues. The remaining sum of Rs. 6·20 crores was transferred to the Railway Reserve Fund, bringing the balance in that Fund to Rs. 38·13 crores.

[1] Subsequently extended up to 31 March 1942.

The revised estimates for 1946-7 placed the surplus at Rs. 8·64 crores. In accordance with the *ad hoc* Agreement arrived at in the previous year fixing the railways' contribution for 1946-7 to general revenues at a sum equal to 1 per cent of the capital at charge on commercial lines less loss on strategic lines plus half the balance remaining after setting aside Rs. 3 crores for the Betterment Fund (created in 1946 for providing amenities to the public and the railway staff by means of an initial transfer of Rs. 12 crores from the Railway Reserve Fund), general revenues were expected to receive Rs. 5·61 crores. As a result of the partition, the Indian Union came into possession of a total railway mileage of 33,865 with capital-at-charge of Rs. 678 crores, Depreciation Fund equal to Rs. 93·22 crores, Railway Reserve Rs. 7·98 crores, and Betterment Fund Rs. 11·71 crores.

During the 7½ months ended 15 March 1948, the working of the railways showed a deficit of Rs. 2·74 crores, which was met by withdrawal from the Reserve Fund. In 1948-9 the Reserve Fund had sunk to the low figure of Rs. 3·8 crores while the Central Pay Commission's recommendations involved an expenditure of nearly Rs. 27 crores with a substantial additional burden in prospect in respect of the Adjudicator's Award with its generous provisions for hours of work, leave and relief staff. The revised net surplus for 1948-9 was placed at Rs. 15·83 crores which was distributed as follows: General Revenues: Rs. 7·34 crores; Betterment Fund: Rs. 0·84 crores; Railway Depreciation Fund: 7·65 crores.

In view of the large arrears of replacement and the increased cost of replacement due to rise in prices, the Indian Railway Enquiry Committee (Kunzru Committee) have recommended an annual contribution of about Rs. 22 crores for five years. The revised estimates for 1949-50 showed a surplus of Rs. 11·02 crores, out of which Rs. 7 crores were contributed to the general revenues and Rs. 4·02 crores to the Depreciation Fund.

The Convention of 1924 became inoperative from 1 April 1943. According to a resolution adopted by the Assembly in March 1943, the surplus on commercial lines in 1943-4 was to be shared with the general revenues in the proportion of three to one after repaying any outstanding loan from the Depreciation Fund. Further surpluses on commercial lines were to be divided between the general revenues and the railway reserves according to the needs of each.

The Convention Committee which was set up in 1949 discarded the complicated 1924 formula and adopted instead a simpler and more easily workable arrangement under which general revenues have to be paid a dividend of 4 per cent on the capital-at-charge. A sum of Rs. 31·85 crores [1] has been provided in the budget for 1950-1. The surplus for 1950-1 is estimated at Rs. 14·01 crores (revenue Rs. 232·50 crores minus expenditure Rs. 218·49 crores), which is to be distributed as follows: Railway Development Fund Rs. 10 crores, Railway Reserve Fund Rs. 2·01 crores; Railway Depreciation Fund Rs. 2 crores.

Local Finance

§48. **Local (Rural) Boards.**—Since the vast majority of the people of India live in rural areas, far greater importance attaches to District and Sub-District Boards

[1] This is inclusive of Rs. 2.57 crores for the ten State lines covering a route mileage of over 6,500 which came under Central control and management from 1 April 1950.

than to the municipalities which serve the numerically insignificant urban population. At one time Provincial Rates or surcharges on land used to be an important item in the Budget of the Central Government. Today, however, they form a substantial part of the revenues of District and Local Boards, representing a proportion of total income varying from 25 per cent in Bombay to 63 per cent in Bihar and Orissa (in 1922-3). They were originally started in Bombay and Madras between 1865 and 1869 and were levied on land chiefly for the construction and repair of roads, the upkeep of schools and dispensaries, village sanitation and other local expenditure. The principle was extended in pursuance of Lord Mayo's scheme of financial decentralization. In 1871 Acts were passed levying similar cesses in Bengal, the United Provinces, and the Punjab. In the Punjab and Oudh, cesses for roads, schools and the District post, assessed at the time of the land revenue settlement, were continued side by side with the new general cess. Similar settlement cesses were introduced in the Central Provinces, Burma and Assam, which were later replaced by a general cess. Between 1871 and 1905, there were added certain cesses for Imperial purposes. The Famine Insurance Fund was instituted in 1878, to which were added, in some Provinces, cesses for Provincial purposes, chiefly for the payment of village officers. The financial improvement in the position of the Government of India made possible the abolition in 1905-6 of all cesses levied for other than local purposes. In some cases, however, the effect of this reform was not to reduce the amount of the cesses levied, but to transfer the fund from Provincial to local purposes, the Provincial Government being compensated from the Imperial Treasury. Recently there has been a tendency in some Provinces either to increase the general rate or, as in Madras, to add new cesses for specific local purposes such as elementary education. The basis of these local cesses on land varies with the system of land revenue. Thus in the ryotwari areas of Bombay, Madras, the Central Provinces and Berar, and in the temporarily settled areas of Assam, the cess is levied on the basis of land revenue. In the United Provinces and the Punjab, on the other hand, the annual value is taken, with twice the land revenue as the basis. In the permanently settled areas either the rental value or the acreage is accepted as the basis. As regards the rates of the cesses, they are left to the discretion of the local bodies, subject to certain maxima and minima laid down by the Provincial Legislatures. The land cesses are collected along with the land revenue but are largely administered by the local bodies. The limits vary from 6¼ per cent to 12½ per cent.[1] The land cess, although it is not proportioned to ability to pay, being levied at a flat rate, is everywhere recognized as an appropriate tax as it is applied for the benefit of the properties which gain by the activities of the Local Boards.

§49. **Municipal finance.**—The main source of the income of municipalities is rates and taxes, which account for about two-thirds of the total. The remaining one-third is derived from municipal property, contributions out of Provincial revenues and miscellaneous sources. The taxes levied by the local authorities may

[1] According to the Layton Report there is no longer any excuse for the retention of the maximum (which in some Provinces has been one anna in the rupee, and has remained unchanged for over fifty years) because (i) the land revenue no longer represents a very high proportion of the net produce, especially in the permanently settled Provinces, and (ii) all the other cesses on land have been abolished. See *Simon Commission Report*, par. 275.

be grouped under four heads: (i) Taxes on trade, for example octroi duties, terminal taxes, tolls, etc.; (ii) taxes on property, for example taxes on houses and their sites (and in rural areas the cess on land); (iii) taxes on persons, for example taxes on circumstances, professions, trades and callings, on pilgrims, on menials and domestic servants, etc.; and (iv) fees and licences. Fees are either for specific services rendered by the municipality, such as scavenging fees, or are partly of the nature of luxury taxes and partly levied for purposes of regulation, such as licenses for music, vehicles, dogs and other animals, etc. There are also license fees for offensive and dangerous trades. The Taxation Enquiry Committee point out that considerable vigilance is necessary in respect of indirect taxes, such as taxes on trade taking the form of octroi, terminal taxes and tolls, so as to prevent undue interference with inter-Provincial traffic. Special objection is taken to the octroi and terminal taxes which offend against all the canons of taxation, and substitutes such as a tax on retail sales or profession taxes are suggested. Another important suggestion of the committee is in favour of increased assessment of town property which benefits largely from municipal activities. The machinery for collection and assessment, however, would have to be far more efficient for this purpose than it happens to be today. The heaviest items of expenditure are on public health and convenience, public works and education. The municipalities are often unable to meet their expenditure from ordinary revenues and have generally therefore to borrow money, either from the Government or in the open market, to carry out such large projects as water supply, drainage works, etc.

The average municipality in India is very poor in resources. Bombay and Calcutta stand head and shoulders above an average municipality in this country in point of the size of revenue they enjoy. But they cannot stand comparison, for instance, with the city of Glasgow which, with a population approximately equal to that of Calcutta, has twelve times the income of Calcutta.

§50. **Inadequate resources of local bodies.**—Considering the devolution of powers to local bodies that has taken place and the wide range of functions assigned to the municipalities, rural boards and panchayats, such as Public Health, Education, etc., since Lord Mayo's time and especially since the transfer of Local Self-Government to popularly elected Ministers, the resources of these bodies are at present utterly inadequate. It is impossible for them to introduce modern standards of administration unless they are put on an ampler financial basis.[1] Under the constitutions of 1919 and 1935, the local bodies were called upon to meet expenditure on services previously rendered gratis by Government servants belonging to the various departments. Also, in the first flush of enthusiasm the local bodies forgot that 'all undertakings depend upon finance', and launched costly and ambitious schemes of education, medical relief, etc., which were beyond their powers. The financial difficulties thus caused were later met by retrenchment, additional taxation and partly also by a more careful distribution of the

[1] The poverty of our local bodies stands in marked contrast with the rich resources of similar bodies elsewhere. For example, as the Simon Commission point out, 'local rates of all kinds, urban as well as rural, produced in 1927-8 in British India about £12½ millions, which is only little more than the income from rates in that year of the London County Council alone'.—*Simon Commission Report.* vol. I, par. 377.

available resources. However, fundamentally the financial position of local bodies remains highly unsatisfactory. Their difficulties have been enhanced recently by increase in expenditure due to high cost of labour and materials, revision of pay scales and payment of dearness allowances to the staff, while their sources of revenue continue to be slender and inelastic.[1]

§51. **Causes of inadequacy of resources.**—Apart from the general low taxable capacity of the people and their unwillingness to tax themselves for local purposes, another important factor explaining the inadequacy of local resources is the unfair distribution of revenues between the Central, Provincial and local authorities. In England the bulk of the contribution from land goes to the local bodies, the Central Government receiving only a very small amount as land tax. In India, on the other hand, taxation of agricultural land has been a Provincial fiscal source, and the principal source of revenue (local fund cess) of local boards is thus under Provincial control. As the Provincial Governments themselves have not been provided with adequate sources of revenue, and yet have had to undertake several schemes of economic and social reform, they have been driven to levy new taxation, such as a tax on immoveable property as in Bombay or sales taxes or the entertainment tax, which should have been left to the local bodies. The Bombay Local Self-Government Committee (1940) observed: 'The fiscal fields of the Provincial Government and of the local authorities are not clearly demarcated and the former has been exploiting potential sources of revenue' which should rightly belong to local bodies. The necessity for demarcating clearly the spheres of Provincial and local finances appears to be urgent. One of the reasons for the financial weakness of the local bodies in India is that the local bodies have developed by the process of devolution of powers instead of the process of a federation of strong, semi-independent smaller units into larger political units. Another reason is that the jurisdictions of the local bodies are usually so extensive as to remove them from effective touch with taxpayers. Had it not been for this, the imposition of taxes on houses and persons by local bodies in the villages would have been easier. From this point of view, the restoration of the influence of the village panchayats and a limitation of the functions of the bodies at present operating would be desirable.

§52. **Improvement of resources.**—Though the recommendations of the Decentralization Commission and the introduction of the Reforms (1919) led to considerable financial freedom being conferred upon local authorities, there has been no material change so far as the nature of the taxes imposed is concerned except that the taxes which may be levied without the sanction of the Government of India have been specified in the Scheduled Taxes Rules.[2] The Taxation Enquiry Committee made the following recommendations with a view to increasing the resources of the local bodies: (i) standardization of the land revenue at a low

[1] See *Report of the Administrative Enquiry Committee*, Bombay, 1948, p. 196.

[2] The Scheduled Taxes which the local authorities can impose under these rules are tolls; taxes on land and land values; taxes on buildings; on vehicles or boats; on animals; on menials and domestic servants; octroi duties and terminal taxes; taxes on goods imported into or exported from a local area; taxes on trades, professions and callings; taxes on private markets; taxes for services rendered, for example, water rate and drainage tax; and fees for the use of markets and other public conveniences.

rate so as to give better scope for local taxation; (ii) transfer to local bodies of a share of the collection of Provincial Governments from ground rents in towns and from an increase in the rates of non-agricultural land; (iii) empowering municipalities to tax advertisements; (iv) extending the scope of taxes on entertainment and betting; and giving local bodies a substantial share of the proceeds; (v) extending and improving the administration of the taxes on circumstances, property and professions; (vi) reducing the import duty on motor cars and enabling the Provincial Governments to levy a provincial tax in lieu of tolls for distribution to local bodies; (vii) empowering local bodies in selected areas to levy a fee for the registration of marriages; and (viii) supplementing the resources of local authorities by subsidies which should be ordinarily restricted to services of national importance and granted in such a way as to enable the Provincial Government effectively to enforce efficiency.[1] The Bombay Local Self-Government Committee endorsed most of these recommendations and made the following proposals for improving the resources of local bodies. Sources of municipal revenues could be increased by (i) a tax on the transfer of immoveable properties; (ii) an assignment of a share of non-agricultural assessment on building plots within municipal limits; (iii) taxes on marriages, adoptions and feasts; (iv) an assignment of the entertainment tax and of 50 per cent of the revenue derived from a surcharge on electricity. For rural local bodies the Committee recommended (i) an increase in the local fund cess from 1 anna to 1½ annas or even 2½ annas; (ii) the levy of a cess of 1½ annas on forest revenue derived from major forest produce and (iii) an assignment of 10 per cent of the land revenue. The Committee rightly pointed out that the method most suitable to local bodies lies in taxes and cesses levied upon the people for definite services rendered to them, e.g. a compulsory education cess.[2] Another way of increasing the resources of the local bodies is to extend the scope of municipal trading and enterprise so as to lessen the existing dependence on taxes. In view of the comparative inelasticity of the local taxes it is desirable to make use of non-taxation sources to a larger extent than at present. In Western countries, the scope of municipal domain—landed estates and especially industrial and trading domain—is on the increase and there are municipal tramways, waterworks, gas and electric works, burial grounds, bathing establishments, fisheries, docks, bakeries, theatres, inns and restaurants, mills, factories, dairies, etc. All these enterprises are apparently not only rendering effective service to the civic population but are also a substantial source of revenue for the municipalities. This aspect of local finance has been largely neglected in India and it appears worth while for the local bodies to explore its possibilities so as to add to their slender resources and increase the amenities of civic life.

The failure of local self-government in India is due to a variety of causes such as the apathy of the electorate, lack of civic spirit among the elected, inadequate financial resources, ill-trained and low-paid staff and want of continuous guidance and control on the part of the Government. No substantial results can be achieved unless the Government make a determined effort to stimulate civic consciousness among the public through the spread of literacy, and exercise

[1] *Taxation Enquiry Committee Report*, pars. 194-6.
[2] *Report of the Bombay Local Self-Government Committee* (1940).

proper control through grants-in-aid, strict audit and regular inspection. The Bombay Administrative Enquiry Committee suggest that day-to-day supervision and guidance should be supplied by a Government agency under a Local Self-Government Commissioner or through a statutory non-official board representative of the local bodies themselves and commanding their confidence and co-operation.[1]

[1] See *Report*, Sections 375-81.

CHAPTER XIII

UNEMPLOYMENT

§1. **Scope of the chapter.**—A permanent margin of unemployment among industrial workers is a feature of the economic system called into existence by the Industrial Revolution in Western countries. Depression in industry after the war of 1914-18 created an unemployment situation of unprecedented magnitude. But though the evil then manifested itself on a scale unknown in the past, the phenomenon of industrial unemployment itself is sufficiently familiar in the West.

With us here in India, the problem of unemployment presents aspects which are somewhat different from those found in Western countries. In the first place, the vast majority of the population depends upon agriculture, and we have already seen that, in most parts of India, there is seasonal unemployment in agriculture for five to nine months in the year during the slack season; and we have discussed the question of suitable supplementary industries to keep the cultivator occupied during this period of enforced idleness. But a more serious aspect of the unemployment problem presents itself in connexion with the periodical occurrence of scarcity or famine, due to a partial or total failure of the monsoon, leading to a partial or complete stoppage of agricultural operations over wide areas, and disengaging a vast quantity of agricultural labour and of labour employed in industries subsidiary to agriculture. This is by far the most serious form of unemployment to which India is liable.

Turning to occupations and industries other than agriculture, we may distinguish between the manual or hard-handed workers, and the intellectual and clerical or soft-handed workers constituting the so-called educated middle class. Regarding the former category of industrial workers, it is clear that unemployment among them, though not unknown, does not as yet exist on the Western scale for the simple reason that our industrial development is not yet of an advanced character. Such organized industries as we had were no doubt caught up in the world-wide depression of 1929-33, and there existed a good deal of industrial unemployment in India as in the case of the other industrial countries of the world. Owing to the closure of workshops and factories or retrenchment in them, a number of operatives, skilled and unskilled, were without work. But in more normal times the complaint is rather that there is scarcity of industrial labour than that there is unemployment among its ranks. Moreover, unemployment when it does come has not the same terrors for the operatives in India as in the West, owing to the fact that most of our industrial labourers have predominant agricultural interests. Often indeed work in a factory is regarded as a second string to the bow and is taken up only during the slack agricultural season. Industrial unemployment in India differs from the corresponding phenomenon in the West not only as regards the scale but also as regards the nature of the problem it creates for the State. To a certain extent the problem is automatically solved in India by many of the unemployed returning to their villages. The distress is in this way merely *transferred* from the industrial to the

rural areas, and not really remedied. But it at least largely disappears from sight so far as the industrial centres are concerned and one does not see as in Europe shoals of the unemployed walking the streets of our industrial cities in vain search of work.

As distinguished from unemployment among industrial workers in organized industries, there is some unemployment among cottage workers. In our chapter on the economic transition in India[1] and our discussion of the position of cottage industries,[2] a general idea has already been obtained as to the manner in which the different classes of artisans have been affected by the transition, and we have formed some notion of the hardship and distress which have been the portion of many of them, who, having lost their old occupations, have not found a satisfactory substitute for them.

Another species of unemployment which is a comparatively modern growth in India is middle-class unemployment, affecting those who have attained a certain standard of education and who depend more or less exclusively upon non-manual or clerical occupations. This is a problem that has recently pushed itself very much to the forefront.

In this chapter we propose to concentrate attention on rural unemployment due to famines and middle-class unemployment.

Rural Unemployment: Famines and Famine Relief

§2. **Responsibility for famines.**—The frequent occurrence of famines in the last quarter of the nineteenth century accompanied by a political awakening of the people gave these calamities a prominence which possibly they would not have attained otherwise. Indian publicists attributed their severity to the industrial, financial and land revenue policy of the Government. By the great majority of people, the British Government came to be regarded as the sole cause of famines, and this facile view of things was not disturbed by unimpeachable historical evidence of equally, if not more, severe famines in the pre-British days. This uncritical attitude elicited the cheap retort that famines were entirely due to failure of rains—a circumstance beyond the control of the British or any other Government. This, however, rather missed the point of the critics, who blamed the Government not for withholding rain but for causing the impoverishment of the people which made them incapable of resisting the effects of occasional scarcity. In this chapter, however, we are not concerned with locating the responsibility for Indian poverty but with the less contentious subject of the nature of Indian famines and the machinery devised to combat them.

§3. **Economic effects of famines.**—The economic effects of famines are bound to be disastrous in a preponderantly agricultural country like India. The heavy mortality due to sheer starvation, which used to be a regular feature of the famines in the old days, has ceased to characterize modern famines, though the epidemics which still follow in the wake of famines send up the mortality figures very greatly. There is a general lowering of the efficiency of the surviving people, and the suspension of cultivation involves a great economic loss to cultivators. Food famines are often accompanied by fodder famines, and the resulting loss of cattle

[1] Vol. I, ch. v. [2] Ch. ii, §§39-46.

further hampers agriculture. There is also an adverse reaction on trade and industry because of the reduction in the purchasing power of large numbers of people. Public finance is greatly disorganized and the Government is hit hard both on the side of revenue which inevitably shrinks and of expenditure which equally inevitably expands.

§4. **History of famine relief.**—It is wrong to suppose that in the pre-British days there were no famines at all or that they were less severe than in the present days. We read that in the famine of 1291 whole families drowned themselves as an escape from starvation, also that in the famine of 1555 people tried to live on the hides of dead beasts, and that the famine of 1630 actually led to cannibalism. Famines were in fact more common in pre-British days than in modern times while, owing to defective communications, the system of famine relief was inevitably less effective than at present. There were central granaries at the capitals which were originally maintained as war chests, but which in times of famines could be used to feed the starving poor. As communications were undeveloped, the village rather than the Central Government became the vital organism of society, and it was the surplus grain stored in the villages from which any relief could be expected. The efficacy of this arrangement depended on the intensity of the famine and its duration. The construction of public works like canals and tanks or the erection of temples, mosques, forts or palaces at public expense gave employment to a number of people and may have been useful in mitigating distress. Lastly, it may be believed that the kings occasionally attempted direct charity, which, however, from the nature of things could not have been anything but inadequate as a remedial measure. The present view as to the responsibility of the State in this matter is a very recent growth.

Coming to the British period, the most important famines during the regime of the East India Company between 1760 and 1857 were those of 1770, 1784, 1802, 1824 and 1837. Excepting the first in the list, these famines did not receive the same elaborate attention, either at the hands of the Government, or of the historians, as the famines of the latter half of the nineteenth century. The minds of people were preoccupied with other grave matters, such as the continuous wars, the widespread disorder caused by the sudden introduction of unfamiliar judicial and land revenue systems and a corrupt administration in the hands of ill-paid and inexperienced officials, unemployment on a large scale caused by the sudden demobilization of the troops of Indian princes, the depredations of the Pindaris, etc. The political and administrative preoccupations of the Company made it indifferent to the question of the economic regeneration of the people. Even if it had the opportunities, it is doubtful whether it would have had the will to do anything, because its whole outlook was vitiated by commercial considerations and it seemed to be more concerned with the dividends of its shareholders than with the lives of those from whom these dividends were drawn. The Company in the later years of its existence acknowledged in a general way its obligations to the famine-stricken people ; but it failed to evolve any systematic famine policy. Slipshod and spasmodic efforts were made to deal with famines by regulating prices and trade in corn, encouraging emigration and occasionally undertaking public works. But all this was mere tinkering with a vast problem.

It is to the period following the transfer of India to the Crown in 1858 that we must turn for the elaboration of a proper system of prevention, insurance and relief evolved through many experiments and failures. In this period fall several great famines such as that of north-west India in 1860, of Orissa in 1865, of Rajputana in 1868, of Bihar in 1873, of South India in 1876 and the two widespread famines of 1896 and 1899-1900 which affected various parts of India, including Bombay, Madras and the Central Provinces. The Orissa famine of 1865 affected five crores of people and was responsible for a heavy mortality of ten lakhs. The Government were slow to take action in the beginning, though food was later poured in large quantities into the affected areas. The great loss of life in this famine led to an inquiry presided over by Sir John Campbell, and the Government announced their definite policy to save life at any cost. In the Bihar famine of 1873 the Government erred in the direction of indiscriminate charity and excessive expenditure. The great South India famine of 1876-8 involved a mortality of 52 lakhs. This led to the appointment of the first great Famine Commission presided over by Sir Richard Strachey, and on the measures taken by the Government of India at the instance of this Commission is based the subsequently elaborated machinery of famine relief. Among the steps taken by the Government may be mentioned the introduction in 1878 of a Famine Insurance Grant by which a sum of Rs. 1½ crores was provided in the annual budget of the Government of India to be spent on direct relief if there was a famine, and on the construction of public works of a protective nature if the year was normal; the extension of communications by the system of the ' new guaranteed railways '; the clear definition of the principles of famine relief as provision of work to the able-bodied at a wage sufficient to secure health but not ordinary comforts, and gratuitous relief to the infirm in their own villages or in poor-houses; assistance to the landowning classes by way of takkavi loans; and the suspension and remission of land revenue. Famine codes embodying these principles were made for every province. These codes were put to a severe test during the famines of 1896-7 and 1899-1900 and were amended in the light of the experience then gained. The earlier of these famines was followed by the appointment of a Commission presided over by Sir James Lyall, which made certain recommendations for the relief of special classes like weavers and hill tribes, proposed rules for the management of charitable funds, advocated a freer grant of gratuitous relief in villages, but disapproved of the extension of decentralized relief works. The second of these famines came too rapidly on the heels of the first to allow the Government time to consider these recommendations. In 1900 the Maharaja of Jaipur donated Rs. 16 lakhs to constitute the nucleus of the Indian Peoples' Famine Trust. In 1901 the last Famine Commission under Sir Antony Macdonell emphasized the importance of ' moral strategy ' or ' putting heart into the people ', that is, assisting the people by loans and other means immediately danger is scented, by the prompt and liberal distribution of takkavi, early suspension of land revenue, and a policy of ' prudent boldness ' involving the preparation of a large and elastic plan of relief, constant vigilance and full enlistment of non-official help. The Commission further drew attention to the necessity of devising measures for tackling a fodder famine and of saving cattle. Lastly it recommended the starting of co-operative credit societies

and the extension of State irrigation works of a protective character. The amended famine codes embodying these principles have well stood the test of subsequent famines, such as that of the United Provinces in 1907, of Ahmednagar in 1912, and the far more serious scarcity of 1918 and 1920, and these visitations of nature may now be said to have been brought more effectively under human control than ever before in the history of India.

§5. **Change in the nature of famines.**—One main cause why this satisfactory result has been brought about is that the nature of famines has entirely changed. The Special Commission of 1867 defined famine as 'suffering from hunger on the part of large classes of population', but the history of famines in India is largely a discovery of a change in the meaning of that word brought about by two main factors: first, the improved means of communication and transport by which deficiency in one part can be relieved by drawing upon the abundance in other parts; and secondly, the progressive perfection of the administrative organization dealing with famines. Modern famines are thus not food famines but money famines, and what the State is called upon to do is to provide work and wages on an adequate scale. At present a famine is more accurately described as a temporary dislocation of employment due to the failure of crops, than as widespread death from starvation. Famine relief therefore primarily consists in providing employment for those against whom nature has declared a temporary lock-out. When ordinary employment fails, the Government open relief works on which practically everyone who seeks employment gets it and is supposed to earn enough by way of wages to enable him to buy just sufficient food.[1]

§6. **Classification of causes and remedies.**—The causes of famines may roughly be divided into two kinds: (i) immediate and direct causes like drought or the after-effects of drought; and (ii) remote but fundamental causes which have to do with the intense poverty of the people and their consequent inability to resist the slightest disturbance of the normal economic life. The first kind of causes can be met by the adoption of measures for the alleviation of distress or by making wise provision beforehand and remaining always in a state of preparedness to meet the calamity. Storage of grain and fodder and all insurance schemes are instances of previous preparedness. To deal with the second kind of causes we must dig deep down into the fundamentals of the question of Indian poverty. The solution of this tremendous problem has to be approached from many sides and involves the adoption of an all-round intensive programme of economic regeneration.

§7. **Direct causes and remedies.**—The chief direct cause of famines being deficiency or total failure of rains, it would be clearly an advantage if the probable character of the coming monsoon could be foretold. The Meteorological

[1] Even before the partition India was a net importer of foodstuffs. After the partition the Indian Union has become even less self-sufficient than before in respect of food-supply and the declared aim of the Government to achieve self-sufficiency by March 1952 is unlikely to be realized. The problem now therefore is not only that of moving internal supplies of foodstuffs quickly to relieve occasional local scarcities due to failure of rains, etc., but also that of making up for the chronic over-all shortage in the country as a whole by imports from foreign countries including Pakistan.

Department keeps a regular record of the weather conditions prevailing in the different parts of the country. It is supposed that these data and especially a scientific study of the conditions prevailing in the upper strata of the air are capable of furnishing sufficient clues for making successful forecasts about the monsoon. Excessive rains and floods are also causes of famines, but the damage due to these can generally be repaired with comparative ease. Locusts and other insect pests and various kinds of fungi are often responsible for failure of crops. Government mycologists and other experts are engaged in fighting these causes.

§8. **Famine Insurance and Relief Funds.**—The precautionary measures against famine include the Famine Insurance Grant mentioned above. The Government of India used to allot funds out of this grant to the different provinces according to their needs. Before the Reforms famine relief had come to be a regular divided head of expenditure, the Central Government bearing two-thirds and the Provincial Governments one-third, of the expenditure. But after the financial decentralization that followed the Reforms of 1919 each province was required to provide for its own famine insurance out of its revenues annually. The unspent grant formed part of the Central balances on which the Central Government paid interest. The balances of the fund could be spent on (i) relief of famine, (ii) construction of protective works for prevention of famines, and (iii) grant of loans to cultivators. A scale of the Famine Insurance Fund was laid down, and each Provincial Government was required to contribute from its resources a fixed sum every year for Famine Insurance in proportion to its liability to famine.

The constitution of the Famine Insurance Fund underwent a radical change with effect from the financial year 1928-9. Under the new regulations, the Fund ceased to be an Insurance Fund. It was called the Famine Relief Fund and it provided as its main object for expenditure on famine relief proper ; the word famine being held to cover famine due to drought or other natural calamities. Accordingly, the annual assignments from the revenue, as well as the balances till they exceeded a certain amount, were not expended save upon the relief of famine. Loans to cultivators were not granted from the new Famine Relief Fund direct, though the Fund might advance money for financing the Provincial Loan Account if and when its balance exceeded the prescribed minimum. The balances at the credit of the old Famine Insurance Fund on 31 March 1928 were transferred to the new Fund on 1 April 1928. In Assam, where no Famine Relief Fund had been created, the balances at the credit of the old Famine Insurance Fund were transferred to the general balance of the province. The additions to the Famine Relief Fund during the year 1939-40 amounted to Rs. 13·45 lakhs ; the total withdrawals, to Rs. 24·29 lakhs ; and the closing (gross) balance on 31 March 1940 was Rs. 3,07·67 lakhs.[1]

The Constitution under the Government of India Act, 1935, contained no provision for a separate Famine Relief Fund. From the institution of Provincial Autonomy on 1 April 1937 the balances at the credit of the Fund were handed over to the provinces, and it was left to Provincial Governments and their legislatures to take the measures hitherto prescribed for them.

[1] See *Finance and Revenue Accounts of the Government of India* (1939-40), Table No. 92.

Funds from the Indian Famine Trust are used to help the poor from the superior classes who cannot accept Government relief in the ordinary way. For meeting famines when they actually occur, however, the Government mainly rely on the relief organization which was evolved in the latter half of the nineteenth century.

§9. **Description of relief measures.**—A brief description of this organization will give the reader an idea of the elaborateness of the machinery and of the minute care with which it has been perfected.[1] (i) Standing preparations are made on a large scale. Valuable information is gathered about climatic conditions, crops and prices, births and deaths ; programmes of suitable relief works are kept ready and brought up to date ; the country is mapped out into relief circles ; and reserves of tools and plant are stocked. (ii) When rains fail, a careful look-out is kept for danger signals such as rise in prices, restlessness of the people, their aimless wandering, contraction of private charity, and increase in crime, especially petty thefts. (iii) The Government then take preliminary action and declare their general policy as based on moral strategy. Meetings are called at which Government policy is explained to the people, non-official help is enlisted, suspension of revenue is declared, and loans for agricultural improvements are made. Village inspection begins and preliminary lists of helpless persons are prepared. (iv) Then follows the first stage of actual relief. Test works are opened and, if considerable labour is attracted to them, they are converted into relief works on the principles laid down in the famine codes. (v) The next stage commences from December. Central relief camps are organized and gratuitous relief is given to the infirm in the villages. Poor-houses are opened in towns, and village kitchens are run for the benefit of children. The distress reaches its climax in May when there is fear of an outbreak of cholera. (vi) The last stage begins with the advent of the rains. The large relief works are closed down and people are moved in batches to smaller relief works near their villages so as to prevent the spread of epidemics and to facilitate the restoration of normal agricultural conditions without needless delay. Local gratuitous relief is extended and liberal advances are made to cultivators for the purchase of cattle, ploughs and seed. When the principal autumn crop is ripe, the few remaining works are gradually closed down and gratuitous relief ceases. The famine is ordinarily at an end by the middle of October. All this time the medical staff is kept ready to deal with cholera and malaria, diseases which generally appear when the rains break out. The Woodhead Famine Inquiry Commission for the first time enunciated the principle that it is the ultimate responsibility of the State to provide food for all. The summary of the conclusions and recommendations of this Commission has been given as Appendix A to Volume I, 8th Edition, 1947.

§10. **Ultimate causes and remedies.**—The great poverty of the people is the ultimate cause of famines, and throughout this book we have been considering one or other of the numerous features of Indian poverty, such as the excessive reliance of the population on agriculture—an industry dependent on an uncertain rainfall—the decay of old industries and the absence of new ones, and a peasantry steeped in indebtedness, living from hand to mouth, without any reserve to fall back upon in times of scarcity. The remedies for increasing the economic strength

[1] See *Imperial Gazetteer of India*, vol. III, pp. 477-81.

and staying power of the masses include a great variety of measures such as raising the credit of the cultivator and his standard of living ; construction of direct and indirect protective works like irrigation canals, roads, and repairing wells ; improvement in general administration—more especially land revenue administration with a reasonably light assessment and a sympathetically administered system of suspensions and remissions ; a well-thought-out and liberal forest policy; improvement of agriculture through the agency of the agricultural department, agricultural colleges, research institutes, etc. ; the fullest utilization of the co-operative movement ; development of large-scale industries and encouragement to cottage industries—in short, economic planning for the country in all its aspects.

Middle-Class Unemployment

§11. **The scope of the problem.**—The terms ' educated ' and ' middle class ' are in common use, but it is not easy to draw precise dividing lines between the educated and the uneducated, or between the middle class and the higher and lower classes. It is usual to include in the term 'educated middle class' such persons as are not well-to-do enough to dispense with earning their own living, who follow non-manual occupations and have received some form of secondary or higher education. Sometimes, however, those who have at least completed the full vernacular or anglo-vernacular course are also regarded as coming within the definition of the ' educated class '.

§12. **The seriousness and extent of middle-class unemployment.**—Middle-class unemployment had in recent years assumed alarming dimensions[1] and attracted widespread public attention, and Central and Provincial Legislatures, as well as semi-official bodies like the Universities, have of late interested themselves in this problem.[2] Between 1924 and 1928 a series of investigations through specially appointed committees were carried out in some of the Provinces (Bengal, Madras, Bombay and the Punjab) and also in some of the Indian States such as Travancore. The most recent committees were those appointed by the United Provinces Government (1935, under the chairmanship of Sir Tej Bahadur Sapru), and by the Bihar Government (1937).[3]

The Reports of all these committees left no doubt regarding the all-India character of the problem of unemployment among the middle classes.[4] The Madras Committee pointed out that the proportion of educated men seeking employment to the demand for them was roughly two to one, and as the result of

[1] The recent war created many new avenues of employment and educated unemployment was practically non-existent for the time being. The Employment Exchanges of the Ministry of Labour, Government of India, originally intended for the benefit of ex-Servicemen and discharged workers, are now thrown open to all categories of employment-seekers.

[2] The Conference of Indian Universities held in 1930 considered the question, but had nothing more to suggest than that Universities should collect statistics regarding unemployment among their products.

[3] The Bombay Labour Office in 1938 initiated a fresh inquiry into unemployment among university graduates.

[4] An interesting review of the situation regarding middle-class unemployment in the different provinces and Indian States and of the measures of relief, either adopted or contemplated, will be found in *Proceedings of the Ninth Industries Conference* (1937), Bulletins of Indian Industries and Labour, No. 65.

certain calculations about the annual output of schools and colleges and the proportion of vacancies occurring in the natural course of things, they concluded that the amount of unemployment was very distressing. The Punjab Committee (1927) after similar calculations found that, whereas the output of anglo-vernacular schools and colleges had more than doubled during the five years 1922-7, there had been nothing like a corresponding increase in the number of posts available in the Government Departments or in commercial and business firms.

Unemployment of this type is a more serious evil than is commonly recognized. Besides the individual suffering it causes to the unemployed, their disappointment and sense of injury produce a general demoralization which is cumulative in its effect from generation to generation. The existence of a large number of disgruntled young men is also dangerous to the political stability of the State. The point has been well put by the Sadler Commission : ' The existence and the steady increase of a sort of intellectual proletariat, not without reasonable grievances, forms a menace to good government especially in a country where . . . the small educated class is alone vocal. It must be an equal menace whatever form the Government may assume. So long as the great mass of the nation's intelligent manhood is driven, in ever-increasing numbers, along the same, often unfruitful, course of study, which creates expectations that cannot be fulfilled, and actually unfits those who pursue it from undertaking many useful occupations necessary for the welfare of the country, any Government, however it may be constituted, whether it be bureaucratic or popular, must find its work hampered by an unceasing stream of criticism and a natural demand for relief which cannot possibly be met.' Again, the gospel of revolutionary socialism or communism finds willing devotees in young men who nurse a strong sense of personal injury against a scheme of things in which apparently they have no place.

§13. **Classes particularly affected.**—The Bombay Enquiry found that numerically the most important section affected consists of young persons below 27 years of age, especially those whose training has been purely literary and who have proceeded to higher education through the Anglo-vernacular course. As might be expected, unemployment was most acute among those who had not succeeded in passing the School-Leaving or Matriculation examination which is considered to be the minimum qualification for Government service, less so among matriculates and intermediates, (comparatively) least of all among graduates with professional qualifications. In the teaching profession there was more unemployment among untrained than among trained teachers. As regards the legal profession, it was commonly agreed that it is much overstocked. Similarly, the medical profession was overcrowded in the larger towns, though there was a paucity of medical men in the villages and smaller towns, where the amenities of life were poor and the people not accustomed to pay regular cash fees for medical relief. The position of engineers was only slightly better. There were large numbers of persons fit and willing to be employed on the railways, but who were not yet trained, and therefore failed to get employment. As regards banking and accountancy, while those who had received advanced special training or acquired experience did not remain without jobs, there were scores of others who had had no special training and who failed to get employment.

§14. **Causes of unemployment.**[1]—(i) *Post-war economic depression and retrenchment.*—India, like the rest of the world, was hit by the post-war economic depression. Large numbers of persons employed in the clerical and the combatant branches of the army were discharged on the cessation of the war of 1914-18 and it was not possible to absorb them elsewhere, as even the normal volume of employment offered by Government and semi-public bodies and business firms was not available. The axe of retrenchment was applied in all directions and even the old establishments were not fully maintained. The economic depression became particularly severe during the years 1929-34 and the middle classes along with others passed through a period of unexampled distress.

(ii) *Defects of the educational system.*—Another alleged cause of unemployment is the lack of adjustment between the system of education now in force in the country and the needs of industrial progress. The opinion is widely held that our present system of education is such as to produce persons qualified almost exclusively for clerical occupations, and that it is regarded almost as an avenue to Government service.[2] Sir George Anderson, in his note prepared for the Punjab Committee, admitted that ' in its very inception, it (the present system of education) was moulded with the special object of preparing boys for external examinations, the passing of which is for many only a snare and a delusion and with the object of training boys for clerical vocations which are now proclaimed to be overstocked and which offer insufficient avenues of employment to large throngs of applicants ', and he proceeded to describe the matriculate, whom he regarded as the crux of the problem of unemployment, as ' a derelict, a wanderer on the face of the earth, unemployed because he is unemployable '.[3] The average educated Indian looks first to Government service as a means of livelihood and, failing that, to clerical work under some semi-official body, such as railways, municipal and other local bodies, port trusts and the like. A further charge made against the educational system is that it renders boys unfit for their ancestral occupation, as they cannot for a minute picture themselves stooping so low as to earn their living with their hands, and prefer being fifth-rate clerks after a smattering of education to earning a better income in the so-called manual occupations, including agriculture. The ranks of those who have traditional aversion to manual labour are thus swelled by

[1] The Bengal Committee suggest a classification of unemployment based on a distinction between a man who is unemployed through no fault of his own and another man who is unemployed because he is really unemployable in the type of available employment he seeks, frequently through causes over which he has no control. See *Report of the Bengal Unemployment Committee*, par. 2.

[2] ' Our high schools and colleges suffer not for want of vocational training but for their concentration on training of a definitely vocational but very limited type. Essentially practical and utilitarian, they have aimed at the production of Government officials, lawyers, doctors, and commercial clerks.'—A. Mayhew, *The Education of India*, p. 149.

[3] As the Bengal Committee observe, one great defect of the educational system is that it leads to one end only, namely, the M.A., M.Sc., or B.L. examination. ' It is like a *bamboo*, each joint being an examination and the diameter remaining practically the same size from the root to very near the top. It has no branches and the crowning top covers a very small area. What is required is a spreading tree with branches going off in as many directions as possible at definite points along the trunk, not all at the top.'—See *Report of the Bengal Unemployment Committee*, par. 29.

the present system of education[1] which is 'sterilizing' and tends to 'diminish the intellectual energy of those who receive it and is in many cases a positive disadvantage to them'.[2] The agricultural, artisan and backward classes themselves are trying more and more to send their children to schools and colleges with a view to Government service and the learned professions and thus promote themselves to the higher rungs of the social ladder. This fatal fascination exercised by literary and quasi-literary occupations, within whose range of influence even the classes who have had no tradition of 'letters' are being increasingly drawn, further emphasizes the prevailing unemployment among the educated classes. We must, however, add that while it is true enough that parents do not display the necessary vision and foresight in choosing occupations for their boys, this may to a certain extent be attributed to the absence of suitable and adequate facilities for practical education—agricultural, technical, industrial or commercial.

(iii) *Social causes.*—There are also certain social causes such as the caste system, early marriage, the joint-family system and communal inequalities, all of which 'operate powerfully though silently in determining as well as impeding the economic ambitions and fortunes of the educated men'.[3] For instance, caste fiat prevents educated men from taking to useful occupations which are regarded as undignified in the particular communities to which they belong. Early marriage not only interferes with adequate training but also places too early in life the responsibility of maintaining a family on the shoulders of young men. The joint-family system, while it makes the burden of this responsibility lighter and offers protection to the weak and the helpless,[4] leads to economic parasitism and cramps individual initiative and ambition. Unwillingness to move out of their abodes and seek their fortunes away from their homes, which is one of the results of the joint-family system, is another suggested cause of unemployment among the educated classes. On the other hand, according to the Madras Committee on middle-class unemployment, this immobility is on the decrease and has little bearing on the bulk of unemployment, which is mainly the result of the supply of men being far in excess of the demand for them.[5]

(iv) *Economic backwardness.*—The most important cause of middle-class unemployment is the very poor industrial development of the country and the paucity of openings available for educated young men. In England there are altogether about 16,000 occupations excluding the army, navy and the civil services. In India there are perhaps less than 40.[6] The mere extension of the facilities for vocational and technical training, it must be remembered, does not fully meet the situation. It will no doubt speed up the development of industries but it will

[1] This is indicated by the large proportion of the educated unemployed in Madras being sons of cultivators, as revealed by certain figures collected in connexion with the census of 1931.

[2] Sir Philip Hartog's evidence before the Bengal Committee.

[3] *Madras Report*, p. 18; see also vol. I, ch. iv.

[4] The *Bombay Report* shows that 49·46 per cent of the total, or nearly half the unemployed persons in the Presidency, were supported by their relatives during the period of unemployment, 8·15 per cent maintained themselves on previous savings, 7·67 per cent by casual work, 4·91 per cent by income from real property. Cases in which the unemployed had to depend upon vicarious charity were comparatively few. See op. cit., par. 94.

[5] *Madras Report*, pp. 18 and 27.

[6] See *Travancore Report*, par. 58.

not by itself call them into existence unless special measures are adopted simultaneously for the promotion of industries to absorb the trained men. As the Bengal Committee (*Report*, par. 30) wisely remark, ' In an ideally balanced development technical training and economic progress should proceed forward together, each being stimulated in turn by the other. When one lags it should receive a stimulus and vice versa '. In the usual discussions about the cause of unemployment, sometimes exaggerated emphasis is placed on the excessively literary character of the present system of education in this country and on the presence of caste prejudices, to the neglect of other factors such as the under-development of the economic resources of India. This, as has been repeatedly pointed out, is at the basis of the poverty of the masses and, in the last analysis, dominates all species of unemployment.

§15. **Remedies for unemployment.**—*Employment Bureaux.*—The causes of unemployment being many and various, there can be no one sovereign remedy for it. In the first place, certain palliatives which have been put forward may be noticed. Employment bureaux run by universities, Government departments or private agencies, have been suggested. Employment Boards have been established in the United Provinces and the Punjab, for bringing together employers and the unemployed. These would undoubtedly serve a useful purpose, if efficiently managed, so as to secure public confidence. We must, however, remember that they can at the most bring about a better adjustment between supply and demand, especially in the case of private business firms where people employed are not usually of sufficient qualifications. They cannot provide any corrective to the growing excess of supply of men in relation to the demand for them.

Migration or emigration has also been proposed as an antidote to unemployment, but since middle-class unemployment is an all-India problem, migration within the country can hardly be regarded as a solution. It can only equalize the intensity of the problem in all parts of the country. As regards emigration, we have already argued elsewhere that, in the existing circumstances, not much relief can be expected from it.[1]

§16. **Employment exchanges.**—During World War II organizations known as National Service Labour Tribunals were set up to recruit technical personnel as they were needed for war purposes. These organizations have since been extended and adapted for dealing with the registration and voluntary placement of many skilled and semi-skilled workmen during peace-time. The Directorate-General of Resettlement and Employment was set up in July 1945 to look after the resettlement and employment in civil life of demobilized ex-servicemen and discharged war workers. The scope of the functions of the employment exchanges has recently been widened considerably to deal with the resettlement of refugees and industrial workers generally. The whole organization is in charge of a Directorate-General with three Directorates under it, namely (1) Directorate of Employment Exchanges, (2) Directorate of Training, and (3) Directorate of Publicity. The country is divided into eight regions, each under a Regional Director of Resettlement and Employment. There are 54 Employment Exchanges and 23 District Employment Offices. The Central Employment Exchange acts as an

[1] See vol. I, ch. iii, §§ 27 and 33.

inter-provincial clearing-house to balance the supply of and demand for labour within the various regions.

§17. **Statistical survey of unemployment.**—The Government of India, in a circular issued to the Provincial Governments in May 1937, urged the collection of comprehensive statistical material as the first step towards the adoption of remedial measures dealing with middle-class unemployment. The most hopeful line, it was pointed out, was to collect statistics of employment rather than unemployment, and in order to secure reliable statistics the Government of India consider that legislation is necessary. Such legislation should be Central in order to ensure uniformity, and should command the full support and co-operation of the Provincial Governments. In the first instance it would probably be desirable to restrict the inquiry to organized industry, that is, regulated factories, mines, and railways. Investigations may thereafter be extended to various commercial occupations and possibly less organized forms of employment. Such a survey would furnish a basis for estimating the needs of the various industries and commercial concerns for qualified men with different types of technical qualifications with a view to better correlation of supply and demand. Such statistics would also make it possible to form a general estimate of the potentialities of the absorption offered by industry and commerce for educated young men, whether their qualifications are technical or general, and thus to reach a position where the probable effects of different possible policies on unemployment can be gauged. Lastly, the statistics would help to meet the public need and demand for statistical material and would enable the subject to be viewed in the light of facts rather than conjectures. We strongly support this well-reasoned plea for an all-India survey of employment in India.[1]

§18. **Other remedies.**—As stated above, unemployment of all grades and shades is in the final analysis the reflex action of economic backwardness, and everything that leads to the economic betterment of the country will obviously be a remedy for unemployment. Material advance will not only create fresh avenues of employment for the middle class, but, by raising the general level of prosperity attained by the community, will increase the demand for the services of lawyers, doctors, teachers, etc. Further, with the increase in general prosperity, the scope for employment in the administrative services will expand; and, lastly, we may add that any comprehensive programme launched by the Government for bringing about the regeneration of the country will itself absorb immediately a certain number of the educated unemployed.

The Madras Committee declared that 'the principal remedy for unemployment should be the diversion of the educated middle class, especially those who own or occupy land, to agriculture', and to facilitate this diversion, the Committee desired that 'somehow or other the idea that the agriculturist is socially inferior to the clerk or lawyer, or the teacher, must be uprooted'.[2] The Bihar Unemploy-

[1] In this connexion attention may be invited to the Household Schedule issued with the 1941 census. The schedule provided for certain returns regarding employment means of employment, unemployment, partial or total, and seasonal, calculated to provide valuable data regarding unemployment.

[2] *Madras Report*, p. 25. The Bengal Committee also make a similar suggestion and recommend the amendment of the Agricultural Loans and Land Improvement Act so as

ment Enquiry Committee in their Report (November 1937) expressed a similar view and held that the question of diverting some educated young men to agriculture or, at least, preventing their migration to towns was very important for an essentially agricultural province like Bihar.

The proposal of the Madras Committee to establish 'farm colonies' was of considerable interest, but had its practical limitations. In the first place, barring provinces like the Punjab and Assam, there was not much good cultivable land available to grant to the educated unemployed, even if the superior claims of the village community and the depressed classes were ignored. Secondly, the temptation for middle-class parents to send their children to schools and colleges with a view to Government service would increase if it became generally known that the Government would find land for the unemployed educated young men.

The majority of the Punjab Unemployment Committee suggested that one way of relieving unemployment was to provide facilities for higher education only for the markedly able, who if poor, should be subsidized by the State, or for those who can pay its full cost (par. 19). We do not think that anything should be done deliberately to increase the cost of education or to limit the scope for higher education in the country, though we admit the necessity of somehow making parents realize that the present supply of men far exceeds the demand in Government service and the legal profession, and that it is necessary for them to think of other careers for their children. The Sapru Committee are also against artificially restricting admission of students to the universities. There is more point in the suggestion of the Travancore Committee that the question of recruitment to all grades of Government service by means of competitive examinations should be seriously considered. Definite competitive tests and a stiffening of standards will weed out a large number of candidates and prevent the useless 'dissipation of energy involved in running about to secure recommendations or to cultivate patronage'. Those who fail in the competition will know that Government service is out of the question for them and this will impel them to do something else instead of hanging about indefinitely on the mere off-chance of obtaining an appointment some time. This will also raise educational standards and enable the services to get better recruits.

Lastly, it must be noted that side by side with the improvement of the educational system[1] there must also be a radical change in the social system and in the general outlook of the people. All obsolete ideas and practices which hamper

to assist the *bhadralog* class in Bengal. See *Report of the Bengal Unemployment Committee*, par. 47.

[1] The Government of Bengal have sanctioned a scheme which is calculated to provide vocational training in a number of small industries (such as manufacture of umbrellas, brass and bell-metal articles, cutlery goods, glazed pottery, washing soap, jute and woollen articles of common use) to the youths belonging to the *bhadralog* (middle) class. *Proceedings of the Fifth Industries Conference* (1933), pp. 123-4. See also the Bombay Government's scheme of Trade Apprenticeship for youths who have received education up to the pre-matriculation class (1937). The Government of Bombay more recently (1941) decided in favour of conversion of some of their high schools into agricultural, technical or commercial high schools with a view to providing alternative vocational education for boys who have no aptitude for higher literary studies and are not able to proceed to the university after passing the matriculation examination. It is expected that it will be easier for pupils with technical education to obtain employment in industrial cities like Bombay.

economic progressmust be fearlessly denounced, and sustained and strenuous efforts must be made to destroy them. For, as the Sadler Commission remark: 'The education of a people is not given by schools and colleges alone. Other influences blend with theirs, the spirit and temper of the community which they serve, the power exerted over its thoughts and character by prevalent aspirations and beliefs, the tone of its family life, the rules and restraints imposed by its social organization, the conditions under which its daily work for livelihood is done.'

§19. **The Sapru (Unemployment) Committee.**—We may here refer to some of the more important recommendations of the Sapru Committee on unemployment in the United Provinces as they have an obvious bearing on the unemployment situation in other provinces, and classify them as follows: (i) those which aim at increasing the demand for educated men; (ii) those which aim at avoiding excess of supply; and (iii) those which aim at a proper adjustment of supply to demand (actual or potential).

(i) Municipalities and District Boards should be compelled to employ qualified engineers and supervisors for the purpose of maintaining roads and buildings in an efficient condition. The Government might with benefit provide more employment for qualified medical men by extending the scope of public medical relief, by attaching more private practitioners to public hospitals, by starting investigations conducted through qualified medical men into the efficacy of indigenous drugs, etc. Municipalities and District Local Boards should be compelled to employ properly qualified medical officers for carrying out their duties in connexion with public health and sanitation. The overcrowding of the legal profession may be remedied to some extent by the introduction of greater specialization of functions, e.g., some should specialize in drafting documents, others in arguing cases, etc. The rules regarding retirement of public servants at the age of 55 should be strictly enforced so as to give a chance of employment to new young recruits. Large-scale and small-scale industries should be stimulated so that they might absorb an increasing number of our young men. Vigorous steps should be taken to introduce compulsory primary education, without which no substantial economic progress is possible. This would also mean an increased demand for teachers, and would so far remedy the existing unemployment.

(ii) The High School examination should have two kinds of certificates—one certifying completion of the course of secondary education and qualifying for the subordinate branches of Government service and also for admission to industrial, commercial and agricultural schools, and the other qualifying for admission to Arts and Science colleges. In this manner many students who are really unfit for a university career in Arts and Science will be diverted at the close of their secondary education, and this will reduce the number of unemployable graduates.

(iii) The facilities for practical training in the various technical educational institutions should be extended, and education in general should receive a more pronouncedly practical and, in the case of primary schools, a definitely rural, bias. Medical practitioners should be encouraged, if necessary with the help of generous subsidies, to settle down in rural areas instead of congregating in the few big towns. Steps should be taken to develop new professions like pharmacy,

dentistry, accountancy, architecture, librarianship, insurance work, and journalism, and suitable training should be provided for qualifying for these careers. An attempt should be made to induce agricultural graduates and diploma holders to make scientific farming a means of livelihood. The development of dairy farming would afford another possible avenue of employment for them. Steps should be taken to bring qualified educated men into touch with commercial houses for employment. Regional vocational guidance authorities should be created for this purpose. The Government should broadcast information regarding possible careers and bring into existence suitable machinery for giving sound advice to parents regarding the aptitudes of their boys and the choice of a suitable career for them. Secondary schools should provide much more diversified courses of study than at present, and in the universities greater stress should be laid on scientific and vocational education. An Appointments Board, more or less modelled on the Appointments Board at Cambridge, should be created for university graduates. It should consist of the Vice-Chancellors of the universities, certain heads of departments (e.g. Education, Industries and Agriculture) and some public men and European and Indian business men. Similarly a Board should be created to deal with the products of the secondary schools, medical and agricultural schools, and industrial schools. These Boards should be required to collect statistics of employment among graduates of universities and products of the secondary schools and intermediate colleges.

The only real and lasting remedy for unemployment is increase of production by every available means in agriculture as well as industry. Increasing the production of food-grains by irrigation projects, promotion of large-scale as well as of cottage industries and in case of necessity a judicious use of Government subsidies to private enterprise are the broad lines of policy for grappling with the problem of unemployment.

APPENDIX A

SUMMARY OF THE REPORT OF THE FISCAL COMMISSION, 1949-50

IN formulating a development policy for India, we should keep in the forefront the basic significance of agriculture. The solution of the problem of under-employment in agriculture has to be sought in the concurrent adoption of a twofold programme: first, rationalization of agriculture, i.e. the maximization of production in terms of yield per acre by steadily improving agricultural methods and promoting an intensive system of mixed farming; and secondly, drawing away the surplus forces from land into industries—occupations subsidiary to agriculture, cottage and small-scale industries, large-scale industries and tertiary occupations.

The main problem in agricultural development is how to evoke the enthusiasm of the agriculturist for plans for the betterment of his condition. The greatest need at present in India is an extension service with the object of bridging the gap between research and the practices of producers, similar to those which have been found so valuable in the U.S.A., U.K., etc.

The case for cottage and small-scale industries rests fundamentally on the 'employment aspect' and their true place in the economy of the country is determined by the relative importance of their private and social costs in relation to similar costs of large-scale industries. The rural industries that can be most economically developed are primarily those that depend on the produce of agriculture (including forests) and the manufacture of utility articles of common consumption that do not call for intensive physical effort or the exercise of a high degree of skill or complicated technical processes. The absence of electrical power in the villages will for many years compel rural industries to depend on other forms of motive power, e.g. on steam- or oil-engines.

In each State there might be set up a statutory corporation aided by the State Government to be in charge of the measures which should be adopted for stimulating the growth of cottage and small-scale industries.

A study of the natural and mutable factors of production leads to the conclusion that the pattern of industrialization in India will follow broadly the lines of development in East Continental Europe, China and Japan, and that within the limits set by these basic factors, the pattern of India's heavy industries will be determined by the natural advantages which its iron and steel industry enjoys.

On the assumption that there will be planned policy the following order of priorities for the public sector is suggested: (i) the essential defence industries; (ii) industries connected with the development of natural resources, for example, our water-power and key minerals such as coal and petroleum; (iii) public utility industries, e.g. railway transportation, electric power generation (where it is State managed), etc.; (iv) heavy key and basic industries which in the absence of private enterprise the State may have to initiate and develop.

In the private sector the following priorities may be observed: (i) the increase of production in existing undertakings up to the maximum of their installed capacity; (ii) the expansion of existing industries up to the limits of effective demand in their market with special reference, wherever possible, to export markets; (iii) the establishment and development of industries which are complementary to existing industries in the public or the private sector, e.g. industries which manufacture the components of their industries or which carry the processes of production a stage nearer final consumption; (iv) the establishment of such industries as are related to existing industries and may increase the external economies resulting from the establishment of a group of connected industries; (v) the establishment

of industries catering for a large market, internal and external, rather than those satisfying a limited or specific demand.

In planning the location of industries it will be prudent for the Government to rely in the first instance on negative measures to prevent the further concentration of industries in areas which are already overcongested. Simultaneously, positive steps might be taken to improve the attractiveness from the social point of view of areas to which it is proposed to encourage the migration of existing or new industries. The extent to which the agency of trading estates on the lines of those in the U.K. may be utilized for this purpose merits careful study. Decentralization of large-scale industries and the establishment of large-scale industries in rural areas should be encouraged.

The aim of short-term foreign trade policy should be not merely to achieve equilibrium at an easily attainable level but to create conditions in which current foreign exchange receipts are sufficient to pay for the volume of imports necessary (i) to carry out a production plan based on the most efficient use of existing productive resources and plant capacities ; (ii) to achieve a predetermined programme of investment in essential replacements, re-stocking and in essential new lines of manufacture ; and (iii) to maintain a predetermined level and structure of current consumption.

In order to attain these objectives, it is necessary to attack the balance of payments position on both the demand and supply side. These measures will include (i) monetary, budgetary and other economic measures designed to achieve internal economic stability, i.e. what are known as 'disinflationary measures', (ii) exchange rate adjustments, i.e. devaluation of the currency, (iii) bilateral or regional trading arrangements, and (iv) adjustments in the structure of production.

The object of the country's long-term foreign trade policy should be (i) to direct these short-term developments along channels which will eventually enable the country to consolidate its position in those fields ; (ii) to promote a pattern of import trade by means of which India can obtain the foreign resources necessary for the development of its agriculture and those cottage, small-scale and large-scale industries which it may wish to develop ; (iii) to promote a pattern of export trade (i.e. in volume, composition and direction) that will enable India (*a*) to pay for its essential imports, (*b*) to specialize in those exports in which it may have a comparative advantage, and (*c*) to direct its export trade to those markets in which it will have the least difficulty in maintaining its hold against competition from other countries.

For many years to come the resources of the State would have to be devoted in a large measure to these purposes, and the Central Government should supplement the efforts of State Governments by assisting them especially in regard to multi-purpose and large-scale irrigation schemes.

Small-scale industries : State policy in regard to the development of small-scale industries will have two objectives : (i) the improvement of their production and marketing methods, including all forms of assistance (*a*) to existing cottage industries, in urban and rural areas, (*b*) to such small manufacturing units as operate in rural areas, and (*c*) to all small-scale establishments in urban areas. These different types of cottage and small-scale industries will necessarily require different forms of administrative organization. Appropriate organizations will need to be set up not merely for specific purposes, such as the supply of raw materials or finance or the provision of marketing facilities, but also to deal with the special problems of the different types of cottage and small-scale industries. (ii) Another major field of State activity will centre round the establishment and administration of new small industries in rural areas that may be set up in conformity with a fixed pattern of development. It will be the responsibility of the State to set up the right type of organization for this purpose.

Large-scale industries : A. Industries coming under the planned sector immediately may be grouped under the following classes : (1) Defence and other strategic industries, (2) Basic and key industries and (3) Other industries.

Industries falling under group (1) should be protected whatever the cost may be on national considerations. Regarding basic and key industries coming under the plan, the Tariff Authority will decide the form of protection and the quantum thereof and will (i) lay down terms and conditions for the grant of protection or assistance and (ii) review from time to time the extent to which these conditions have been or are being complied with by the industries.

As regards the third category, the criteria to be applied for granting protection should be as follows :

> 'Having regard to the economic advantages enjoyed by the industry or available to it and its actual or probable cost of production, it is likely within a reasonable time to develop sufficiently to be able to carry on successfully without protection or assistance
>
> and/or
>
> it is an industry to which it is desirable in the national interest to grant protection or assistance and, having regard to the direct and indirect advantages, the probable cost of such protection or assistance to the community is not excessive.'

B. As regards industries which are not included in approved plans, the Tariff Authority should examine the claim for protection on the criteria set out above and submit its recommendations to the Government.

C. Where no approved plan exists, the position should be as follows : (i) Defence and other strategic industries should be given protection whatever the cost may be, on national considerations ; (ii) as regards other industries, the criteria to be applied will be the same as those set out in Section A above.

Some Specific Issues of Protectionist Policy

Availability of raw materials.—Local availability of raw materials should not be a condition for the grant of protection if the industry possesses other economic advantages, e.g. an internal market, available labour, etc.

Protection to new or embryonic industries.—The need for an assurance of protection prior to the actual establishment of an industry is particularly strong in those industries which require heavy capital outlay or a high degree of specialization in personnel and plant equipment, and which are likely to be subjected to intense competition from well-organized and established producers abroad. Agricultural products may be protected, but in granting such protection it should be stipulated that (i) the number of commodities should be kept as small as possible ; (ii) the principle of selection should be (*a*) the importance of the raw materials of industry that they provide and (*b*) the volume of employment that they offer ; (iii) protection should be on an interim basis limited to short periods—never more than five years at a time ; (iv) a programme of agricultural improvement must accompany the scheme of protection and form an integral part of it ; and (v) it should be the special responsibility of the Tariff Authority to report to the Government annually on the progress of technological improvements in the production of these commodities.

On broad grounds, the levy of excises on protected articles is inadvisable and it should be resorted to only where it is needed for budgetary purposes and no alternative sources equally suitable are available.

The Central Government should fix the prices of raw materials of protected industries by Central legislation whenever such price-fixation becomes necessary. Legislation by individual States for this purpose leads to difficulties. A Development Fund should be created by setting aside every year a portion of the revenue

collections from protective tariffs. With such a fund, subsidies, in lieu of or in addition to protective tariffs, can be given more freely. A strong 'after-care' organization to provide facilities necessary for the rapid development of protected industries may be set up in the appropriate Ministry. For purposes of protection to domestic industries, in normal cases, quantitative restrictions should be used sparingly. Temporary quantitative restrictions would, however, be justified against abnormal imports.

Subsidies.—As a general rule subsidies would be preferable to tariff protection in the following cases : (i) where domestic production meets only a small fraction of domestic demand ; (ii) where the commodities are essential raw materials or ingredients of production ; and (iii) where the manufacture of certain quantities or grades of commodities produced in the country needs protection but it is difficult for purposes of levy of import duty to distinguish those grades or qualities from others against which no protection is needed.

Pooling is applicable only to commodities of a highly standardized nature. The Tariff Authority should examine cases where pooling arrangements would eventually reduce the burden on the consumer. In determining the cost of production of a commodity, the Tariff Authority should lay down uniform and standardized rules. A standardized practice might be evolved by the future Tariff Authority in consultation with all interests in the industries concerned regarding the remuneration to be allowed to managing agents for purposes of calculation of costs. The entire subject of the return on capital in protected industries and the valuation of the capital employed or the blocks on which such return is to be allowed should be subject to detailed investigation by the Tariff Authority. Where an element of prejudice is established, the Tariff Authority should add an appropriate margin to the quantum of protection proposed for the industry.

Stores purchase policy.—The stores purchase policy of the Government should be framed so that the indigenous industry receives a reasonable margin of preference over foreign articles subject to the following conditions : (i) All industries run on sound business lines should be eligible for preference on condition that the products conform to such specifications as may be laid down by the Government on the recommendations of the Indian Standards Institute. (ii) A higher margin of preference should be given to the products of cottage and small-scale industries and conforming to such specifications as may be laid down for them.

The obligations of protected industries should mainly be with regard to price policy, production or output policy, quality of production, adoption of technological improvements, research, training of apprentices and higher grades of labour, and anti-social activities.

These obligations should be treated as directive principles of tariff administration and should be embodied in the statute dealing with the establishment of the tariff-making authority. These principles will not be 'enforceable' in the juridical sense but it should be the duty of the Tariff Authority to bear them in mind when it examines the claims of protection of particular industries.

Having made up its mind as to the obligations that should be imposed, the Tariff Authority should work out the conditions subject to which the obligations should be imposed. A programme for implementation should also be worked out.

The Tariff Authority should report to Government in its periodical reviews the manner in which the obligations are being discharged by the protected industries, the difficulties that hamper the discharge of these obligations, the further measures necessary to secure enforcement of the obligations, and the changes in the terms of obligations, if any, that may be called for.

Other Factors in Industrial Development

The difficulty of securing investible funds for financing industrial undertakings has become acute since the beginning of 1947. The major handicaps to capital

formation are stated to be as follows : (i) the fear of nationalization, (ii) the high level of taxation, (iii) the abuses of the managing agency system, (iv) speculation leading to gambling on the stock exchanges, and (v) the shift in the distribution of national income from urban to rural areas.

Capital control in its present form should be abolished. As, however, the Planning Commission has now been appointed, new machinery should be devised for directing capital into approved channels. India's minimum requirement of capital expenditure will be roughly of the order of Rs. 330 crores a year at the current level of prices. A higher rate of savings and investment would involve coercive measures and a degree of austerity in current consumption which it may be very difficult to enforce.

As a general rule, foreign capital should be invited for (i) projects in the public sector of the economy which depend on the import of capital goods, plant, machinery, equipment, stores, etc., from abroad ; and (ii) undertakings in the private sector which involve new lines of production and where indigenous capital and management are not likely to be forthcoming. In special cases, where the quantity of domestic production is small in relation to the total domestic demand and the indigenous industry is not likely to expand at a sufficiently fast rate, there should be nothing to prevent Government from inviting foreign capital on such terms and conditions as they may lay down. Broadly speaking the indirect form of investment is preferable when foreign capital is needed only to pay for foreign machinery and equipment and the type of consultant service that is provided by the manufacturer of such equipment. The direct or equity form of investment is more appropriate in those cases where, besides capital, the technical know-how of the foreigner or his technical knowledge or experience is also needed. The Government of India in the appropriate Ministry should set up a bureau of consultants whose services can be drawn upon by private industry on such terms and conditions as the Government may lay down. Care should be taken by industries to appoint duly qualified technical men and to train suitable men for such positions. The types of expert service that our industries should develop are those connected with plant-capacity and production control, stores and organization control, raw material control, quality control and costing. Early steps should be taken to constitute an Economic Service, as envisaged in the Industrial Policy Statement of 6 April 1948.

The structure and conditions of working of Government or quasi-Government undertakings should be such as to ensure (i) that the community knows the cost of what it is doing, (ii) that the community is satisfied that this cost is equitably distributed, and (iii) that the decisions of the public authority are taken democratically.

To ensure this (i) a periodical review of the working of these undertakings by competent authority with a view to the assessment of their efficiency should be undertaken ; (ii) a Consumers' Council should be attached to each Government or quasi-Government undertaking, with well-defined powers and duties including the study of cost statistics, price structure and price policy, inquiry into complaints from consumers about unfair practices or discriminatory treatment according to a definite procedure laid down by Government, and (iii) a Tribunal on Services and Charges, on the lines of the Railway Rates Tribunal, with functions more or less similar to those of the latter, should be constituted.

The accounts should be maintained on a commercial basis, audited by a competent staff. These audit notes, with reviews thereof, should be placed before the Minister concerned so that Parliament may be kept informed of the manner in which these undertakings are working and their cost to the community. The Government should have special studies made of the problems of management of Government and quasi-Government undertakings in the light of the experience which countries such as the United Kingdom, Australia, Canada and the U.S.A. have acquired.

Industrial research. Organized industrial research in this country is of comparatively recent growth. There are two aspects of research which deserve special mention : (i) the establishment of industrial research institutes should be the joint task of the Government and of the industries ; (ii) the work of the research institutes organized by private industries should be integrated with the activities of the research institutes established or administered by Government or quasi-Government authorities.

There is a prima facie case for making the observance of the approved standards obligatory on the industries concerned—at any rate on those industries which have a large export market or which provide the raw materials of exportable commodities.

Training of labour. Technical institutes on the model of the one recently started by the Indian Jute Mills' Association should be extended to other industries also.

Transport. Consistent with the needs of defence and internal security, a high priority should be given to the development of district and village roads.

The tariff-making authority should be placed on a permanent and statutory footing and designated as the Tariff Commission. The Commission should consist of five members including the Chairman but power should be taken in the proposed Statute to increase the number to seven if necessary. There should also be power to co-opt assessors or advisers for particular purposes. Members should be selected not to represent interests or regions but primarily on the basis of their competence and standing in the profession, business or service in which they are engaged, or in public life. Apart from *ad hoc* investigations, the Commission should submit to the Government a periodical review, preferably triennial, on the working of protected industries. As soon as an inquiry is completed, the Tariff Commission should submit its report to the Government of India, who should arrive at a decision on the recommendations of the Commission ordinarily within a period of two months.

India should ratify the Havana Charter provided : (i) that the other countries of major economic importance, including the U.S.A. and the U.K., have by then ratified it ; and (ii) the economic conditions in the country at that time justify this course.[1]

In regard to the tariff concessions to be received from other countries, India should concentrate on (i) commodities which meet with competition from similar commodities from other countries in the world market ; (ii) commodities which meet with competition from possible substitutes from other countries in the world market ; (iii) manufactured commodities rather than raw materials.

Secondly, in the matter of granting tariff concessions, India should concentrate on (i) capital goods ; (ii) other machinery and equipment ; (iii) essential raw materials.

The special export requirements of the unorganized cottage and small-scale industries, which depend on the foreign market to a large extent, should be borne in mind when India enters into trade negotiations with foreign countries. It should be the particular aim of India's representatives to secure for them the maximum of tariff concessions in the foreign market and to safeguard their position against competitive imports from abroad.

[1] Mr Harold Wilson, President of the Board of Trade, announced in the House of Commons on 8 February 1951 that in the light of the recent statement by the U.S. Administration that they did not intend to submit to Congress the proposal for America to ratify the charter, the British Government could not think of ratifying it, as there was no prospect of the International Trade Organization being established and developed as an effective instrument for fostering international trade.

APPENDIX B

MAIN PROVISIONS OF THE INDO-PAKISTAN TRADE AGREEMENT, 1951-2

BEING desirous of promoting trade between the two countries the Government of India and the Government of Pakistan have entered into the following agreement :

ARTICLE I

(i) The period of this Agreement shall be from the 26th February, 1951, to 30th June, 1952.

(ii) The two Governments agree to permit the exportation to and the importation from the other country of the commodities and goods specified in Schedule I which is attached to this agreement, up to the quantity or value mentioned against each item, during the periods indicated in columns 2 and 3 of Schedule I.

(iii) In respect of such commodities and goods as are, or may be, subject to export or import licence, the two Governments agree to grant upon application duly made, export or import licences up to the quantitative or monetary limits specified in Schedule I, in accordance with the laws and regulations and administrative practices of the Government granting the licence.

(iv) In respect of those commodities in which the export trade is the monopoly of the Government in either country, the terms of the agreement will be deemed to have been fulfilled if the supplies have been made at agreed points within/or without the country and such quantities of the commodities mentioned in column 2 of Schedule I as cannot be supplied before the 30th June, 1951, shall be carried forward to the period 30th June, 1952.

(v) In respect of foodgrain the quantities, period and terms of supply will be as in Schedule III to this agreement.

(vi) In respect of raw cotton, the Government of Pakistan have at present no destinational quotas and India is therefore free to buy any quantity. If, however, destinational quotas are introduced during the period of the Agreement, the Government of Pakistan agree to give India a quota of 400,000 bales in the cotton season 1951-2.

ARTICLE II

The two Governments agree that there shall be no import and/or export trade control restrictions on the movement between the two countries in respect of the commodities mentioned in Schedule II to this agreement, and subject to the conditions specified therein.

ARTICLE III

In respect of the commodities mentioned in Schedule I to this agreement the two Governments agree that except where prices are separately negotiated, neither Government will impose any discriminatory supplement or surcharge or any other addition to the export prices of those commodities.

ARTICLE IV

The commodities and goods described in Schedules I and II refer only to those that are produced, processed or manufactured in India or Pakistan as the case may be.

Article V

The Government of India and the Government of Pakistan agree not to permit the re-export of any of the commodities imported under Schedule I.

Article VI

Notwithstanding anything contained in Articles I and II the two Governments agree that export and import facilities granted by each country to the other shall be no less favourable than those applied to any other country in sterling soft currency area. Current and future import and export licences in respect of sterling and soft currency area countries shall be valid for India and Pakistan, as the case may be.

Article VII

In order to facilitate the implementation of this Agreement, the two Governments agree to hold periodical consultaions with each other in respect of any matter arising from or in connexion with the supply of commodities or goods between the two countries during the currency of and in accordance with this Agreement, and, if necessary, by mutual agreement, alter, extend or supplement the Schedules to this Agreement.

Article VIII

This Agreement shall come into force on the 26th February 1951.

Schedule I

1. *From India to Pakistan*

	Up to end of June 1951	*From* 1 *July* 1951 *to* 30 *June* 1952
Coal	600,000 tons	1,500,000 tons
Hard Coke	10,000 tons	Up to December 1951 and nothing afterwards
Soft Coke	5,000 tons	20,000 tons
Pig Iron	6,400 tons	20,000 tons
Ferro-Silicon	Nil	100 tons
Ferro-Manganese ..	Nil	100 tons
Galvanized Sheets ..	Nil	12,000 tons
Black Sheets	Nil	8,000 tons
Iron & Steel products :		
Rails	7,000 tons (Rails; Wheels, tyres & axles; Structural steel; Electrical steel sheets)	5,000 tons
Wheels, tyres & axles ..		5,000 tons
Structural steel ..		25,000 tons
Electrical steel sheets ..		1,000 tons
M.G. Crossings ..	120 tons	
Mills loose jaws for M.G. steel sleepers in silico-manganese steel ..	200,000 numbers by Oct. 1951	Nil
Keys for M.G. steel sleepers	50,000 numbers by July 1951	Nil
Aluminium circles and sheets ..	Nil	100 tons
High Alumina fire-bricks ..	150 tons	500 tons

	Up to end of June 1951	*From* 1 *July* 1951 *to* 30 *June* 1952
Softwood (jungle wood from Malabar, Assam, etc.) ..	5,000 tons	20,000 tons (including 5,000 tons deodar sleepers)
Hard timber (other than teak)	2,500 tons	10,000 tons (including 5,000 sal-logs & sleepers)
Cement	25,000 tons	75,000 tons
Stone and Ballast ..	As much as transport can stand.	
Paper	1,000 tons	5,000 tons
Linseed oil	750 tons	2,500 tons
Mustard oil	5,000 tons	15,000 tons
Chlorine	50 tons	Nil
Rubber tyres & tubes (other than cycle tyres and tubes and giant and non-standard tyres and tubes) ..	Rs. 5,00,000	Rs. 20,00,000
Handloom Cotton Cloth (loongis, towels, furnishing fabrics, etc.) ..	Nil	15,000 bales (including 10,000 bales of loongis)
Mill-made Cotton Cloth:		
Coarse	Nil	40,000 bales
Medium	Nil	20,000 bales
Fine	Nil	15,000 bales
Cotton Yarn:		
1½ to 9's	Nil	2,000 bales
10 to 14's	Nil	2,000 bales
16 to 20's	Nil	11,000 bales
Hard Cotton Waste ..	200 tons	500 tons
Jute Manufactures ..	12,500 tons	50,000 tons
Shellac	Quantity to be settled later.	

2. *From Pakistan to India*

Raw Jute	10 lakhs bales	25 lakhs bales
Raw Cotton	Any quantity	Any quantity
Hides and Skins		
Cow hides	250,000 pieces	1,000,000 pieces
Sheep skins	200,000 pieces	600,000 pieces
Rice	As in Schedule III	
Wheat		
Gram		
Gur	Such quantities as may be agreed upon from time to time.	
Mustard oil cake		

Schedule II

1. *To and from India and Pakistan*

Fish, fresh and dried. Vegetables, including potatoes, potato seeds, onions, garlic and green and dry ginger. Fruits, fresh and dry. Eggs. Betel leaf (*pan*).

Herbs: crude drugs and medicines. Indigenous drugs and medicines. Printed books, journals, magazines and periodicals. Spices including chillies. Lime and limestone. Poultry. Milk and milk products (excluding butter, ghee and cream). Vegetable and flower seeds. Bamboos and cane and manufactures thereof. Tallow. Castor oil cake and seed. Coir, coir yarn and manufactures. Cigars, biris and biri leaves. Pickles, achards and chutneys.

To and from India and East Pakistan only

Washing soaps. Umbrellas, umbrella parts. Exposed cinema films. Paints and varnishes. Agricultural implements.

2. *From Pakistan to India*

Cotton seed and cotton seed oilcakes. Gowara. Paper khar and sajji. Kapok. Betel nuts. Dhanicha seed. Saltpetre. Gypsum. Asafoetida (*hing*). Soda ash. Cigar wrapper leaf.

From East Pakistan only

Firewood (20,000 tons). Handloom cloth.

3. *From India to Pakistan*

Myrabolams. Electric table fans. Sewing machines. Matches. Bauxite. Silica sand. Khari salt. Readymade garments.

From India to East Pakistan only

Handloom cloth of the following varieties: Sarongs, Kailies, Visakuthu, Burma Lungies, Kasturia, Kakaries, Pattanies, 3 × 1, Gingams, Ammavari-kuppums, Bambans, Jublees, Saronges.

Charcoal.

Schedule III

1. The Government of Pakistan and the Government of India agree to the supply of the following quantities of foodgrains from Pakistan to India subject to 10% more or less at Government of Pakistan's option:

(A) *Foodgrains from East Pakistan:*

	Crop	*Quantity Tons*	*Period of delivery*
(i) Rice		24,000	Upto 30-6-1951
(ii) Wheat ..		16,000	do.
Total ..		40,000	

(B) *Rice from West Pakistan:*

(i) Baluchistan rice ..	1949-50	6,600	do.
(ii) Punjab rice ..	,,	600	do.
Total ..		7,200	

(C) *Rice from West Pakistan :*

(i) Kangni ..	1949-50	20,500	Up to 30-6-1951.
(ii) Joshi ..	,,	35,000	
(iii) Red polished ..	,,	2,300	
(iv) Red unpolished..	,,	5,000	
(v) Nara.. ..	,,	1,000	
(vi) Kangni ..	1950-1 1951-2	65,000	55,000 tons up to 30-6-1951 and the balance by 31-12-1951.
(vii) Joshi ..	,,	74,000	
(viii) Red polished ..	,,	10,000	
(ix) Nara and red unpolished ..	,,	5,000	
Total ..		217,800	

Note :—Joshi and Kangni varieties are interchangeable.

(D) *Foodgrains from West Pakistan :*

(i) Rice Sugdasi ..	1949-50	700	Up to 30-6-1951
	1950-1	21,300	Up to 31-12-1951
(ii) Rice brokens ..	1949-50	7,700	Up to 30-6-1951
(Kangni and Sugdasi) ..	1950-1	21,300	Up to 31-12-1951
(iii) Wheat flour ..	1950-1	9,000	Immediately
Total ..		60,000	

(E) *Foodgrains from West Pakistan :*

(i) Rice ..	1951-2	150,000	Up to October 1952
(ii) Wheat ..	1951-2 1952-3	275,000	Up to October 1952
Total ..		425,000	

(F) *Gram from West Pakistan :*

	1951-2	20,000	Up to April 1952
Grand Total ..		770,000	

APPENDIX C

INDIA'S FOREIGN LIABILITIES AND ASSETS[1]

THE following is a summary of a report entitled *Census of India's Foreign Liabilities and Assets* recently (February, 1951) published by the Reserve Bank of India. As on 30 June 1948 India's foreign liabilities amounted to Rs. 1,046 crores.

[1] See *Commerce*, Bombay, 3 February 1951, pp. 190, 223.

Of this Rs. 648 crores belonged to the 'official' sector made up of (i) Rs. 426 crores representing long-term obligations (that is, those maturing after one year) and (ii) Rs. 222 crores representing short-term obligations (that is, those maturing within a year). The long-term obligations included the capitalized pension liability of the Central Government (Rs. 224 crores) and the securities of the Central Government in favour of the International Monetary Fund and the International Bank for Reconstruction. The short-term obligations included the Central Government's liability for surplus war material to the United Kingdom.

The liabilities of the 'private' sector have been divided into (i) portfolio and (ii) 'direct'. Direct investment is accompanied by control and management while portfolio investment implies only the right to receive an income but not to control or manage. The value of portfolio obligations was Rs. 144 crores of which Rs. 78 crores represented short-term liabilities and the balance of Rs. 66 crores represented investments in shares of joint-stock companies. The direct long-term obligations of the non-official sector were valued at Rs. 254 crores made up of (*a*) investment in ordinary shares of controlled Indian joint-stock companies (Rs. 85 crores), (*b*) in branches of foreign firms and companies (Rs. 167 crores) and (*c*) in controlled partnerships (Rs. 2 crores).

Of the total of Rs. 398 crores in the private sector, the amount invested in business activity is Rs. 320·42 crores, of which 72 per cent, i.e. Rs. 230 crores, represents British investments (Rs. 189 direct and the rest portfolio).

Fifty per cent of the total foreign investments is absorbed by only ten lines of investment. Tea plantation is the most important, accounting for foreign capital investment of Rs. 52 crores, of which 80 per cent is of the 'direct' type. Among the other major fields of foreign investments are trading in mineral oils, distribution of electric power, jute and cotton manufactures, etc., all showing the same characteristic of the dominance of the direct type of investment.

As contrasted with this, India's foreign investments are mainly non-industrial and the relatively few industrial investments are mostly of the 'portfolio' type. The long-term assets are composed largely of obligations of foreign Governments. The total value of these assets comes to Rs. 2,391 crores. Of this only Rs. 195 crores belongs to the 'private' sector, while Rs. 2,196 crores belongs to the 'official' sector, consisting mainly of the sterling assets of the Reserve Bank of India.

The above is a summary of India's international position as on 30 June 1948. Since then, however, a number of developments have taken place, such as transfers to Pakistan and deficits in India's balance of payments on account of certain extraordinary items like those on account of defence stores. Moreover, in the estimates of the Reserve Bank, as stated above, long-term foreign investments in India have been valued on the 'equity value' basis. If the 'market value' basis were to be adopted, the estimates would be substantially higher. After taking into account these adjustments, the Report places India's surplus on its investment account at about Rs. 664 crores. Out of this about Rs. 400 crores worth of our sterling assets will have to be earmarked as cover for our currency liability and a further amount for meeting balance of payment deficits. If we also consider the fact that the total amount of Rs. 664 crores mentioned above includes Rs. 353 crores being the aggregate of debts due from Pakistan and Burma (which is likely to present difficulties of realization), our 'creditor' status will have to be admitted to be of a precarious character.

Lastly, if instead of *capital* account we consider the *income* account, setting off our payments against our receipts of interest, profits, etc., we find that the payments exceed the receipts by about Rs. 25 crores, so that our status viewed in this manner is revealed to be that of a *debtor* and not a *creditor* country.

APPENDIX D

REPORT OF THE RURAL BANKING ENQUIRY COMMITTEE, 1950

Main Conclusions and Recommendations

1. Banking facilities are available to the public in this country from a variety of institutions, some of which are not 'banks' in the usual sense of the term. They are treasuries and sub-treasuries; the Imperial Bank of India and other commercial banks; indigenous bankers and institutions; co-operative banks and societies; post office savings banks; and insurance companies and societies.

2. The diversity of banking institutions is inherent in the variety of conditions and circumstances obtaining in different regions of this country, and is the natural consequence of historical circumstances. The differing requirements of people cannot all be provided by one set of institutions and all the various types of institutions have their place in the banking system. What is necessary is to ensure co-ordination in their activities and the maintenance of a minimum standard of soundness, efficiency and service to the people.

3. In considering the extension of banking facilities, the saving capacity of the rural economy, under normal conditions, need not be dismissed as non-existent or negligible.

4. The question whether there have been any savings in recent times in the rural sector is controversial. But, taking the agricultural sector as a whole, available estimates of national income show that its money income has increased threefold since 1931-2, and that its share in the total income has also gone up, revealing a relative shift in incomes. Again, a study of comparative price data indicates that, since 1942, the relation between agricultural and non-agricultural prices has generally been advantageous to agriculturists, and therefore their money income, as well as purchasing power in real terms, and consequently saving capacity, can be said to have increased. Costs of cultivation and prices of consumers' goods have also been increasing along with agricultural prices, but agricultural costs being largely of a local and predominantly rural character, their increase means only a certain amount of redistribution of incomes within the rural community itself. Expenditure on essential goods produced outside the rural economy normally forms a small part of the budgets of the rural people, and such expenditure has, for several years, been limited by the non-availability of several types of goods.

5. Co-operative statistics, reduction of indebtedness, and increase in the balances in rural post office savings accounts reinforce the general conclusion that rural incomes have risen, and a margin has been available for savings.

6. A fairly large proportion of the total agricultural income has gone into the hands of the small minority of big landholders who have also of late benefited from increased participation in money-lending and trade in agricultural produce and livestock. The benefit of debt reduction too has largely accrued to this class, while higher direct taxation which has seriously encroached on urban incomes has not touched them, except to a very small extent. Taking the country as a whole, the major part of rural surpluses, and consequently savings, in one form or other, should be found with the bigger landholders and with some non-agriculturists, such as village moneylenders, traders, owners of mills, etc.

7. Increased incomes and savings of the rural people are being largely used to repay debts and make loans to other agriculturists, purchase lands, gold and silver, improve agricultural equipment and effect improvements to land and, to some extent, to raise consumption levels. The general view is that there are no large cash holdings.

8. Under existing conditions, it would be advisable to concentrate on the consolidation of the progress already achieved, and to plan further expansion on sound and cautious lines, rather than undertake any costly and hasty schemes of expansion of the banking system on the basis of over-optimistic expectations. Such expansion would have to be conceived largely from the point of view of bringing within the framework of the banking system the savings already accumulated and being currently made by the relatively well-to-do rural classes, particularly in the more prosperous regions. To this end, encouragement should be offered to sound commercial banks to open offices as near the rural areas as possible.

9. For the smaller people in rural areas, emphasis will largely have to be placed on the expansion and more effective utilization of post office savings banks and co-operative societies. Attempts will also have to be made to promote thrift and small savings by means of propaganda and group effort utilized to the maximum possible extent.

10. It should be possible for the commercial banks to provide finance for the marketing of produce to a much greater extent than at present when a number of regulated markets are established, the grading and standardization of agricultural produce are developed and satisfactory warehousing arrangements are made. They should also be able to play a greater part in rural credit by making advances on the security of produce and gold, and loans for the purchase of expensive agricultural equipment.

11. At present private moneylenders play the major role in the provision of rural credit, and in any legislation intended to restrict and control their activities, the Government should take account of the pace at which alternative machinery of a satisfactory type can be made available to agriculturists.

12. To enable commercial banks, co-operative banks and land mortgage banks to play an effective role in extending rural credit, it would be necessary to review the existing and proposed legislation concerning debt relief, money-lending, tenancy and land tenures in so far as it may affect their position.

13. The Imperial Bank and other commercial banks should be allowed and encouraged to expand up to taluka (or tehsil) towns, mandis or market towns, or other towns of some commercial or industrial importance. An expansion in the number of offices of the Imperial Bank is desirable in the interest of the rural areas as well as of the banking system as a whole. Co-operative banks can be established in the larger as well as smaller towns, and can go deeper into rural areas than commercial banks. Small villages can only be served by co-operative societies and rural post office savings banks.

14. Banks can to some extent get over the difficulty of having to deal with illiterate customers by arranging their identification through the attestation of their thumb impressions by local persons of importance, keeping a record of their birth-marks, or keeping their photographs. The use of regional languages in the forms and books of banks would also be helpful.

15. The conservatism of the rural population can be overcome by the association with banks of local persons of importance as directors or employees, and regular and persistent propaganda to educate the people in the use of banking facilities. This propaganda should not be entirely left to the Government but should also be undertaken by associations of banks. Officials of banks should deal sympathetically with the rural people and take an active interest in rural social life and agricultural problems.

16. The future structure of banking would thus consist of (i) the Reserve Bank of India with a branch or office in each major province or state, (ii) the commercial banks extending their activities to taluka or tehsil headquarters or other semi-urban centres, (iii) the provincial and central co-operative banks with their branches or affiliated banks, extending to all towns or large villages or centrally

situated villages, (iv) State-owned and State-sponsored Agricultural Credit Corporations or Agricultural Banks, and (v) a chain of land mortgage banks for each region.

17. The number of post offices doing savings bank work in the rural areas should be increased, and the following steps taken to improve their working: (i) The personnel doing savings bank work should be made to take a more active interest in the promotion of savings banks and to deal with depositors in a helpful manner. (ii) In opening new offices, the desirability of tapping rural savings should be given due emphasis. (iii) The regional languages should be used to a larger extent than at present at the sub-office and the branch office level. (iv) Systematic propaganda to popularize the use of savings banks should be carried out. (v) The enforcement of certain rules regarding withdrawals, payments to heirs and dependents on the death of holders, etc., should be made more elastic.

18. The conversion of non-bank treasuries into bank treasuries will not bring large additional funds into the banking system nor will it take banks directly into the villages. It will, however, provide greater opportunities for the rural people to come into contact with banks and enable banks to serve a somewhat larger sector of the rural population, particularly bigger landlords, merchants and traders. It will also encourage the use of cheques, help reduce the handling of cash and result in some saving to the Provincial Governments. Steps should, therefore, be taken to convert non-bank treasuries into bank treasuries at as many centres as possible.

19. There are 274 centres where the turnover on Government account exceeds Rs. 64 lakhs per annum but where the Government cash work is not being managed by the Imperial Bank. At 56 places out of these, the Bank already has an office and it should be possible for it to take over cash work at these places without much difficulty. At the remaining centres, the Imperial Bank and the Reserve Bank should jointly investigate the business potentialities and if sufficient general business is available to enable the Imperial Bank to cover from one-third to one-half of its overheads, arrangements should be made with that Bank to open its branches or treasury pay offices and take over the cash work within the next five years. The question of opening offices by the Imperial Bank at places where the treasury turnover may not be large but where the potentialities of general banking business are good should also be examined.

20. The role of the Imperial Bank in the future banking and treasury set-up of the country should primarily be that of an auxiliary to the Reserve Bank.

21. The change in the political status of the country should eliminate complaints against the Bank which arise from political causes. As regards other complaints from the banking and business community, the following remedial measures are suggested:

(i) Some of the important powers vested in the Government by the Imperial Bank of India Act, 1920, which were allowed to lapse in 1934, should be re-assumed by the Government. The appointment of the Managing Director and the Deputy Managing Director should be subject to the approval of the Central Government who should also have the right to demand their removal from office if they do not continue to enjoy the Government's confidence. The Government Director on the Board of the bank should be re-empowered to ask for the postponement of decisions on questions having a bearing on the national policy of the Government and for the review of those already taken. Government representation on the Central Board should be more effective and nominated directors should have seats on the Committee of the Central Board and be entitled to participate and vote at all meetings of the Committee. Alternatively, the constitution of the bank should be changed on the model of that of the other commercial banks, placing

the overall policy and the general superintendence of the bank in the charge of a Chairman whose appointment would be subject to the approval of the Central Government, and a Board of Directors, two of whom will be nominated by the Government, while the day-to-day internal working of the bank would be entrusted to a General Manager who will be an employee of the bank and will not have a seat on the Board.

(ii) The power of the bank to execute proxies on behalf of shareholders under general powers of attorney should be removed and in view of the special and semi-public character of the Bank the provisions of clauses (iii) and (iv) of Section 12 of the Banking Companies Act, 1949, should be made applicable to it.

(iii) The cost to the Imperial Bank of managing the chests and the monetary value of the various benefits it derives from their use should be worked out in detail by the Reserve Bank in consultation with the Imperial Bank, and it may be ascertained whether remittance facilities allowed to other banks cannot be extended.

(iv) To provide fuller representation to the various regional interests on its Local and Central Boards, the bank may be asked to establish one or two additional Local Head Offices.

APPENDIX E

CENTRAL BUDGET, 1951-2

MR Chintaman Deshmukh, Finance Minister, presented the Central Budget for 1951-2 to Parliament on 28 Feb. 1950. He began his speech with a review of the economic conditions and observed that the year had been one 'of considerable anxiety'. The strain on the country's economy reflected in the rising level of prices and the threat of inflation was aggravated by severe natural calamities like the earthquake in Assam, floods in certain parts of the country and the failure, for the fifth year in succession, of the north-east monsoon over a large part of Madras. The return to normal conditions in the post-war years all over the world had been violently upset by the outbreak of hostilities in Korea and the threat of a wider conflict.

One of the major preoccupations of the Government during the last few years had been to keep prices in check. To prevent a rise in prices consequent on devaluation the Government of India had taken steps by way of price-cuts in certain essential commodities. This had helped the general price index to come down by 12 points from 393·3 at the end of October 1949 to 381·3 at the end of December 1949. It had, however, not proved possible subsequently to check for long the upward pressure, and by June 1950 the index number had risen to 395·6. The outbreak of the Korean War gave a further impetus to the rise in prices, and by September the index number stood at 412·5. Since then it had been more or less steady, although January had registered an increase of nearly 2 points. This increase in prices was not peculiar to India but reflected, to a very great extent, the upward movement in prices in other countries which supply our imports. He indicated the various measures which had been taken by the Government to check rises in price; for example, the amending of the Essential Supplies (Temporary Powers) Act, the promulgation of the ordinance to regulate the supply and prices of a number of essential consumer goods, the setting up of the Prices Advisory Board, the enhancement and imposition of export duties to mop up the difference between the Indian price and the soaring world price.

The level of industrial production in 1950 had been encouraging except in the jute, cotton textile and sugar industries, which had had difficulties in the supply of

raw material. In regard to jute and cotton, he said: 'Provided the season is normal, by March 1952 we shall have made significant strides in the direction of practical self-sufficiency in cotton and jute.' Meanwhile, in order to secure an equitable distribution of the still insufficient available supplies of raw jute, a Central Jute Board had been set up and all purchases of raw jute by the mills compulsorily canalized through it.

The widespread natural calamities which overtook the country last year had caused a serious deterioration in the food situation, and food imports had to be increased from 1·5 million tons estimated in the 1950-1 budget to a little over 2 million tons. It had also not been possible to build up the small reserve of 2 lakh tons contemplated in the budget. It was proposed to import 4 million tons during the year, and efforts were also being made to obtain an additional 2 million tons of wheat from the United States of America. As regards internal production, the Grow More Food plan had been reoriented so as to concentrate efforts in selected areas with an assured water-supply.

For the first time since the recession in 1946, the capital market had shown some signs of revival, although the developments in the international situation during the latter part of the year had arrested this improvement. During the earlier months of the year, the gilt-edged market remained fairly steady and the Government took the opportunity of floating a cash-cum-conversion loan of Rs. 30 crores. The Governments of Bombay, Madras and Madhya Pradesh had also taken advantage of the improved position for floating small loans of their own. Since the middle of 1950, however, prices in the securities market had by contrast been steadier but the flow of available capital in the market was still 'woefully short' of the requirements for implementing the large development programmes and for meeting the reasonable requirements of industry for expansion.

While the internal economic situation had been a matter of concern, the Finance Minister characterized the balance of payments position as more heartening. Except for a short period during the second quarter of 1950, when a slight seasonal fall in exports and heavy payments for imports of raw cotton resulted in a small deficit, the overall balance of payments position had been favourable to India since the last quarter of 1949. India's exchange receipts during the year ending September 1950 amounted to Rs. 638 crores and her payments to Rs. 572 crores, showing a net surplus of Rs. 66 crores. For the year ending September 1949, India's receipts were 517 crores, payments Rs. 766 crores and the deficit Rs. 249 crores. In the 12 months following devaluation, India's exchange earnings had increased by 24 per cent while her payments had dropped by 25 per cent. It was clear from the rise in India's sterling balances, which at the end of January 1951 stood at Rs. 843 crores against Rs. 807 crores at the end of September 1950, that the balance was still moving in India's favour.

The Finance Minister analysed the causes for the improvement in the balance of payments position. The Government had taken special measures for promoting exports and the devaluation of the rupee had raised the competitive capacity of India's exports in terms of foreign currencies. Recent developments in the international situation and the programme of rearmament and stockpiling by Western countries had stimulated the demand for commodities.

It might not be possible for India to maintain this favourable balance for a long period. Unless supplies of raw jute were available the present level of jute exports might be difficult to maintain. Exports of cotton textiles might also have to be curtailed to meet internal consumption; also the volume and value of the country's imports might appreciably rise in the coming year. 'A continued favourable balance of payments brought about by a sudden and large demand for exports is not itself an unmixed blessing,' said Mr Deshmukh. The impact of the higher prices offered for the export commodities directly affected the internal prices both of these commodities as well as of others and, from the point of view

of avoiding inflation, it was necessary to intercept the large difference between the external and internal prices for the benefit of the Exchequer by the levy of export duties. The power to impose and raise export duties recently given by Parliament to the Government, together with the power to restrict imports, the Finance Minister said, would be used to minimize the impact of high external prices on the internal economy of the country.

Speaking of the dollar position, Mr Deshmukh said that, consequent upon measures taken by the sterling area countries to restrict their dollar purchases to 75 per cent of their imports in 1948 and the devaluation of sterling area currencies in September 1949, there had been a marked increase in the gold and dollar reserves in the sterling area. In 1950 the reserves had nearly doubled, and India, with a surplus of $79 million against a deficit of $69 million during 1949, made a substantial contribution to this increase. Allowing for the change in prices the Central reserves were however still very short of their pre-war level and in the rapidly changing pattern of trading conditions it was still necessary to economize in the spending of dollars. The Commonwealth Finance Ministers' Conference held in September 1950 had decided that, while there should be no quantitative limitations on the dollar purchases, each member country should endeavour to secure the maximum economy possible. The dollar position in 1951 was likely to be less favourable than in the previous year largely because of the increased requirements of food from abroad.

The Finance Minister referred to the recent arrangements with the U.K. Government about sterling balances, under which India would have an annual release of 35 million sterling during the six years from 1951 to 1957. Any additional release required for emergent purposes would be the subject of special consultation with the Government of the United Kingdom.

Referring to Indo-Pakistan trade, the Finance Minister mentioned how it had come to a virtual standstill following the non-devaluation of the Pakistani rupee. India's willingness to buy Pakistani goods, if they were available at reasonable prices, he said, was amply demonstrated by the Trade Agreement of April 1950. According to the latest information available, Pakistan had, under this Agreement, supplied to India raw jute worth Rs. 14·46 crores and utilized the bulk of the sale proceeds in the purchase of jute and cotton manufactures and various other goods. In addition, there were certain other commodities, e.g. cotton seed, raw hides and skins, gram, betel nuts, fresh fruits and vegetables, which could move freely between the two countries. The total value of trade in these commodities from April 1950 to September 1950 amounted to Rs. 16·8 crores, imports being Rs. 10·7 crores and exports Rs. 6·1 crores.

The Trade Agreement negotiated in April 1950 expired in September and, as at that time the question of fixation of the exchange rate of the Pakistan rupee was before the International Monetary Fund, the question of entering into a fresh agreement was held over. 'Unfortunately,' the Finance Minister said, 'the I.M.F. postponed a decision on this issue with the result that trade between the two countries again came to a standstill except for trade confined to a few perishable and essential commodities exported and imported freely by the two countries finance for which is found in the free market.' The question of the par value of the Pakistan rupee was still before the I.M.F., and the prevailing international situation re-emphasized the interdependent nature of the economies of the two countries and it was equally in the interest of both that the existing stalemate in trade was ended.

Reviewing the financial position in 1950-1, Mr Deshmukh revealed a surplus of Rs. 7·93 crores as against an estimated surplus of Rs. 71 lakhs at the beginning of the year. As against the budget estimates of Rs. 338·59 crores (revenue) and Rs. 337·88 crores (expenditure), the revised estimates were Rs. 387·21 crores (revenue) and Rs. 379·28 crores (expenditure). The revised esti-

mates showed an increase of Rs. 48·62 crores in revenue and of Rs. 41·4 crores in expenditure.

The increase in revenue was largely accounted for by increase in customs receipts, which were estimated at Rs. 145·31 crores against the budget estimate of Rs. 106·54 crores. Income-tax receipts stood at Rs. 166⅝ crores and the share of the States at Rs. 47¾ crores. The contribution from Railways was likely to be Rs. 6·76 crores—Rs. 39 lakhs more than originally budgeted for.

On the expenditure side, the increase of Rs. 41·4 crores was accounted for by Defence Services (Rs. 11·45 crores) and civil estimates (Rs. 29·95 crores). The bulk of the increase in civil expenditure was due to relief of displaced persons from East Pakistan and increased expenditure on food subsidies. Relief of displaced persons accounted for an increase of Rs. 7·67 crores while subsidies on imported foodgrains accounted for an additional sum of Rs. 7·93 crores. The expenditure on payment of bonus for procurement of foodgrains was expected to show an increase of Rs. 3·84 crores while the supply of food-grains in Delhi State was estimated to result in a loss of Rs. 2·3 crores. Among other items causing increase in civil expenditure was an amount of Rs. 2·64 crores paid for pre-partition claims.

The Finance Minister estimated the total revenue for 1951-2, at the existing level of taxation, at Rs. 369·89 crores and the total expenditure at Rs. 375·43 crores.

The receipts from Customs were placed at Rs. 141·29 crores. In connexion with customs revenue, the Minister said: 'The revenue under this head depends so much on the availability of foreign exchange and the developments in the international situation, which affect both supplies and shipping, that it is difficult, particularly in the present unsettled conditions, to make a precise estimate of the revenue in the coming year.' Receipts from income-tax are placed at Rs. 157·05 crores; contributions from the Railways at Rs. 7·26 crores and from the Posts and Telegraphs at Rs. 2 crores.

Of the total expenditure of Rs. 375·43 crores estimated for 1951-2, Defence Services account for Rs. 180·02 crores and civil expenditure for Rs. 195·41 crores. The distribution of defence expenditure among the various services is: Army, Rs. 130·69 crores; Navy, Rs. 9·31 crores; Air Force, Rs. 24·49 crores; and non-effective services, Rs. 15·53 crores.

Compared with the revised estimates of the current year, the expenditure on the Army shows a decrease of Rs. 12·88 crores, but this has been counterbalanced by increased expenditure on the Navy and Air Force. The decrease in Army expenditure, the Finance Minister said, was mainly due to the fact that the full effects of the reduction in the strength of the Army carried out in 1950-1 would be reflected in the estimates for the next year.

A provision of Rs. 14·97 crores has been made in the Capital Budget for defence purposes. This expenditure will be mostly incurred on works projects for the three services and for the purchase of plant and machinery for the manufacturing establishments.

Civil expenditure in 1951-2 is estimated at Rs. 195·41 crores compared with the current year's revised estimate of Rs. 199·81 crores, showing a reduction of Rs. 4·4 crores. The actual reduction is however somewhat larger as expenditure on grants to States for the Grow More Food and development schemes, which used to be charged to capital, has been provided in the revenue budget for the next year. This amounts to Rs. 8·31 crores. The total reduction in the estimated expenditure is thus Rs. 12·71 crores. This is accounted for, almost wholly, by the reduction in expenditure on food subsidies and bonus on procurement, which is estimated at Rs. 25·32 crores against Rs. 35·07 crores during the current year. Among other factors expected to cause a decrease were reduction in expenditure on displaced persons by Rs. 3·81 crores, a drop of Rs. 1·89 crores in the provision for pre-partition payments and general economy in civil expenditure.

A reduction of Rs. 5·53 crores in civil expenditure was announced by Mr Deshmukh. This figure compared with the Economy Committee's proposal of a cut of Rs. 4½ crores. He mentioned the somewhat limited scope available for contraction of expenditure. Of the gross civil expenditure of Rs. 195·41 crores provided in the budget, nearly Rs. 108 crores represented obligatory expenditure like interest, debt redemption, pensions, fixed grants to the States, pre-partition payments, expenditure on Grow More Food, food subsidies and bonus, relief for displaced persons, etc. Reduction could be effected only in the balance of the amount, viz. about Rs. 92 crores. 'Even here,' the Finance Minister said, 'there is a substantial amount of expenditure on nation-building activities, tax collection and so on which cannot be materially reduced without affecting the revenue or the development of the country.' Also, as a result of integration of the former princely States, considerable, but more or less backward, areas have been brought under direct central administration and the provision in the budget for these areas cannot be reduced.

The revised estimates of capital expenditure for 1950-1 are Rs. 83 crores against Rs. 62 crores in the original budget. Loans to the State Governments have increased from Rs. 34·8 crores (original estimate) to Rs. 67 crores. One of the principal reasons for increase in capital expenditure was that severe pruning had been made in the current year's budget as part of the policy of curtailing expenditure to the maximum extent possible. During the year, it was found that the actual requirements for railways and irrigation schemes proved heavier. An unforeseen payment of Rs. 2·62 crores had also to be made to Pakistan, in accordance with the partition arrangements, on account of the payment of her subscription for membership of the I.M.F. and World Bank. There was also increased expenditure in defence capital outlay. Referring to the increased loans given to the States, the Finance Minister said that these were mainly for expenditure on rehabilitation of displaced persons and for Grow More Food schemes, the first showing an increase of Rs. 7½ crores and the second of Rs. 10¾ crores.

For the next year, a total provision of Rs. 77 crores had been made for capital outlay and Rs. 62·62 crores for loans to the States. Among the important items included in the capital budget are: Railways Rs. 19·62 crores; Posts and Telegraphs, Rs. 5·45 crores; Industrial Development projects, Rs. 10·56 crores, and Schemes of State Trading, Rs. 13·68 crores. Loans to States include provision for river valley schemes (Rs. 27 crores), rehabilitation (Rs. 16 crores), and Grow More Food schemes (Rs. 8 crores).

Referring to the ways and means position, the Finance Minister said that the current year's budget included Rs. 75 crores from market borrowings, Rs. 28 crores from small savings and Rs. 10 crores from sale of securities in the cash balance investment account. In June 1950, a cash-cum-conversion loan of Rs. 30 crores had been floated. Sales of securities in the cash balance investment account had amounted to Rs. 23 crores while net receipts from small savings were placed at Rs. 31 crores. The total borrowings had, however, still fallen below the estimate by Rs. 29 crores. 'This,' Mr Deshmukh said, 'has been mainly due to the fact that the recovery in the capital market has not been as good as was once expected and that the promise of increased demand for investment of the earlier period has not been maintained.'

As regards small savings, there had been 'a welcome, though slight, improvement in the position'.

Recently a Treasury Savings Deposits scheme had been introduced, the results of which were encouraging. The mobilization of small savings was engaging the constant attention of the Government. The Finance Minister stressed the need for the development of a wide network of savings groups and the need for the co-operation of all sections of the community in this effort.

The Finance Minister proposed an increase in the rate of Corporation tax from two annas six pies to two annas nine pies. The additional revenue was estimated at Rs. 2·25 crores. He also proposed to levy, exclusively for central purposes: (i) A surcharge of five per cent on all income-tax and super-tax rates, excluding Corporation tax. This levy would yield Rs. 6 crores. (ii) A surcharge of five per cent on the duty payable on all items in the import schedule, except such as were governed by specific agreements. (iii) Rs. 80 per ton export duty on groundnut kernel. (iv) 150 per cent surcharge on import duty on ale, beer, spirits and fermented liquor. The additional yield would be Rs. 40 lakhs. (v) An increase of five per cent in the excise duty on motor spirit.

Black pepper and cotton waste export duty was to be raised and was expected to yield Rs. 1 crore. The export duty on cotton cloth, which was withdrawn in 1949 and confined to coarse and medium cloth made mostly of Indian cotton, was to be ten per cent *ad valorem*, yielding Rs. 2·5 crores. The excise duty on kerosene was to be increased by five per cent. Changes in the tobacco tariff were expected to yield Rs. 13 crores, and a sales tax in Delhi State was expected to yield Rs. 1 crore. Fresh taxation proposals were expected to yield Rs. 31·15 crores.

APPENDIX F

RAILWAY BUDGET, 1951-2

THE main features of the Railway Budget for 1951-2 presented by Mr N. Gopalaswami Ayyangar to Parliament on 22 Feb. 1951 were as follows:

The traffic receipts for 1951-2 were estimated at Rs. 279·5 crores. Passenger rates were increased by three pies per mile for First Class, two pies for Second Class, 1·5 pies for Inter. Class and one pie for Third Class. Mr Ayyangar estimated the additional earnings from the proposed enhancement of passenger fares at about Rs. 19 crores. Including this amount, the surplus for 1951-2 was estimated at Rs. 21·85 crores. The estimated surplus for the current year was now Rs. 14·24 crores. In 1951-2, the total gross receipts on the present levels of fares and freight rates were estimated at Rs. 260·40 crores—three crores less than the revised estimates for the current year. The estimate of working expenses for 1951-2 had been placed at 186·75 crores, 6·44 crores more than the revised estimates of the current year.

The Railway Minister also announced Government's decision to regroup Indian Railways into six zones and that the first, the Southern Zone, merging the M. & S.M., S.I.R. and Mysore Railways, would come into existence from 1 April. It was the intention of the Government to form zones as far as possible on the basis of the existing patterns, i.e., either on a district basis or a divisional basis, so that the transition might be smooth, entailing the least disturbance to operation and reducing the movement of staff to the minimum. At the headquarters of each zone there would be deputy heads of three major departments, viz. operating, mechanical engineering and civil engineering, each of whom would be individually responsible to the head of his department at the zonal headquarters. There would be substantial reductions of the overheads of the zone as a result of the fusion of the higher administrative organizations of two or more railways into one. The pooling of locomotives and rolling stock in the larger jurisdiction of the new zones would afford more scope for more intensive and balanced utilization of power and equipment, thus leading to a reduction in the number of locomotives and in consequence in capital and maintenance costs.

The Minister for Railways informed the House that the recommendations of the Central Pay Commission had been extended to all Railway employees,

including those who were in receipt of low scales of salaries on the ex-Indian States Railways. He added that the anomalies resulting from the application of the Central Pay Commission scales had also been examined at great length by the Joint Advisory Committee, the representatives of both railway and labour and the Railway Board, with an independent chairman. The bulk of the recommendations of this Committee had also been implemented at the cost of additional recurring expenditure of Rs. 2 crores. The total bill for the year on labour welfare was Rs. 7·95 crores. Mr Ayyangar said that the relations of labour with the management had generally been cordial and there was a growing consciousness of responsibility among the great majority of railway workers and this had found an expression in an improvement in productivity measured by the yard-stick of train miles, vehicle miles, etc., from 69·38 in 1949-50 to 78·1 in 1950-1. He further added that a plan for greater association of labour wherever possible with the administration, had taken a step forward by providing for the association of labour representatives in the formulation of proposals for labour welfare work, including the provision of hospitals, canteens, staff quarters and the like. It was expected that, in the coming years, the field of collaboration would be extended further.

He also made a reference to the voluntary offer made by the railway workers a year ago for a monthly deduction in their wages as their contribution to the Railway Savings Provident Fund. The proceeds of this contribution which the workers concerned had agreed to make for a period of two years would be returned to them at the end of the period with interest at 2 per cent.

The Minister told the House that the Indian Railways had established records in respect of many aspects of railway working in the years 1949-50 and 1950-1 and that the year 1951-2 promised to be a year of steady progress and prosperity. In the number of passenger miles, originating ton miles and train miles, railway operation in 1949-50 and 1950-1 showed results all the more striking when considered in the context of the difficulties under which they were achieved. The locomotive factory at Chittaranjan had gone into production and the stock of passenger coaches had also been augmented by fresh acquisitions and by an increased productive capacity in existing workshops. Passenger amenities were being given greater and greater attention. The level of efficiency in administration was gradually rising and there was significant change in the attitude of officers and men in dealing with trade, industry and the travelling public. On the financial front the position was not only sound but comfortably so.

The Railway Minister told the House that, although the Railways had lent impressive support through the earmarked funds to the general ways and means position of Government, he had willingly agreed to a limitation of the Railways' demands for the allocation of Government's capital resources with a view not to starve or severely curtail the resources for developmental activities in agriculture, industry, other forms of transport and in fact all those Governmental activities which ensured security and economic development.

The immediate problem facing the Railways was the magnitude of their rehabilitation requirements. The repairs and replacement of railway assets had been neglected from the early thirties, when they were caught in the doldrums of the depression. The emergence from the trough of depression and the attempts made to overtake arrears of maintenance and rehabilitation were rudely interrupted by the war which started in 1939. When the hostilities ended, the Railways were left with major problems which were not susceptible of immediate solution. Carefully drawn-up, long-term plans of post-war rehabilitation and development were stultified by the effects of partition. While during the last three years considerable improvement had been registered in spite of tremendous difficulties facing the railways, a good deal of damage still remained to be remedied. The minimum requirements for a period of five years, commencing from 1950-1, were

1,250 locomotives, about 60,000 wagons and about 7,500 passenger coaches in terms of four-wheelers.

Besides rehabilitation and replacement, the standard had to be raised in every direction so that the railways might stand comparison with railways elsewhere in the world. A vast country like India could not continue a policy of starving expansion indefinitely. The need for construction of new lines to fill gaps and to open unopened country was clamant. All this meant a higher level of expenditure, both revenue and capital, and hence the decision to enhance passenger fares.

The Transport Minister explained that the proposed enhancement of fares was also otherwise intrinsically justified by a study of the economics of railway operation. The price level in the country had now risen to about 400 as compared to 100 in 1938, which was fully reflected in the increase in the wage bill of the railways. The cost of fuel now stood at 471 taking the figure of 1938 as 100. Against all this, the increases in average freight rates and passenger fares were of the order of 73 per cent and 46 per cent respectively. Economies in administration and operational expenditure had been and were being comprehensively explored.

Passenger fares in India were made uniform in January 1948. This equalization, however, hardly produced any perceptible effect on the revenue of railways as the average distance travelled by passengers was of the order of 32 to 33 miles. The passenger fare today was only 46 per cent more than the fare in 1938-9. The freight structure was rationalized in October 1948, when some of the unduly low rates were also raised. The overall increase in freight rates works out to 73 per cent in 1949-50 compared with 1938-39. In other words, the incidence of the increase had been borne mainly by goods traffic. In considering any further adjustment of the freights, it was also necessary to bear in mind the possible inflationary stresses and their inevitable repercussions on the price level of both consumer and industrial goods. On these considerations, the Minister said, it would be extremely inadvisable to raise freight rates further and therefore additional revenue would have to be secured by an adjustment of the passenger fare structure. Passenger fares in India were among the lowest in the world. They did not bear any relation to the actual economic situation in the country or to the economics of railway operation. 'While in all sectors of the economic life in this country,' he said, 'we have called upon consumers of goods and services to pay high prices and incur large sacrifices, we have continued to acquiesce in the consumers of rail transport not contributing their legitimate share to easing the burden of large increases in the cost of railway operation.'

The actual result of working for the year 1949-50 was a surplus of Rs. 14·59 crores against Rs. 11·02 crores anticipated in the revised estimate of that year. In 1951-2 the gross receipts were expected to rise to Rs. 263·40 crores or an improvement of about Rs. 31 crores over the budget estimates. The original estimate of working expenses, viz., Rs. 166·59 crores, was likely to rise to Rs. 180·31 crores due to the decision to extend the application of the Central Pay Commission's pay and allowances to the staff of ex-States Railways which came under the control of the Centre with effect from 1 April 1950, anti-sabotage and other security measures for prevention of accidents, and repairs to damage caused by natural calamities. Additional provision had also to be made to overtake arrears in repairs and maintenance of rolling stock and track in view of the rapid deterioration in the international situation. Similarly, the acceleration of the implementation of the Adjudicator's Award and the recommendations of the Joint Advisory Committee approved by Government necessitated increased additional expenditure which had been provided in the budget.

An additional provision of Rs. 13 crores for appropriation to the Depreciation Reserve Fund has also been made in the revised estimates of the current year as

the appropriation to the Fund should accord with the trend of withdrawals from the Fund, which is of the order of Rs. 35 crores per annum. As a result of the variations, it is now estimated that the surplus in the current year will stand at Rs. 14·24 crores against Rs. 14·01 crores estimated in the budget. Out of the surplus, 10 crores will be taken to the Development Fund as originally provided and Rs. 4·24 crores to the Revenue Reserve Fund.

Turning to the financial prospects for the Budget year, the Minister did not anticipate any significant variation in the volume of import or export traffic carried by rail. As regards the internal traffic, he stated that, though the major industries were maintaining their current position and the crop position next year was unlikely to be worse than that in the current year, there were trends to indicate that we had reached the peak in our earnings in the goods traffic. Receipts from goods traffic have, therefore, been placed at Rs. 2 crores or about 1·5 per cent less than the revised estimates of the current year. As regards the passenger traffic, it is expected that the present level would be maintained, particularly as new rolling stock has been put into service and greater amenities are being provided for lower classes of travel. The Minister, however, uttered a note of warning that, while the additional capacity and facilities which were being created at additional cost would improve the conditions of travel, it did not necessarily follow that additional passenger traffic would be attracted to offset the increased costs. A slight drop in revenue in parcels traffic is however anticipated in the coming year. Accordingly, the total gross receipts, on the present levels of fares and freight rates, would be of the order of Rs. 260·40 crores, which is three crores less than the revised estimates for the current year. The estimate of working expenses for 1951-2 has been placed at Rs. 186·75 crores, which is Rs. 6·44 crores more than the revised estimates of the current year. The increase is mainly due to additional expenditure on staff for Rs. 3·86 crores, on maintenance for Rs. 2·66 crores and on freight on fuel for Rs. 13 lakhs. Including the additional earnings of about Rs. 19 crores, which are likely to result from the enhancement of the fares, the surplus for the year 1951-2 is estimated at Rs. 21·85 crores, which is proposed to be distributed between the Development Fund (Rs. 10 crores) and the Revenue Reserve Fund (Rs. 11 85 crores).

The Minister stated that the three Railway reserve funds were well-stocked and the total of the funds' balances to the credit of Railways would stand at Rs. 160·88 crores at the end of March 1952.

The additional revenue resulting from the adjustments of fare structure would go into these earmarked funds and be held to the Railways' credit, for which general revenues would be paying interest until the latter were in a position to release them for expenditure in future. No fraction of the additional amounts raised would be annexed by the general finance and the sums in their entirety would contribute to the strengthening of the capital reserve of the Railways to be drawn upon in the coming years when the ways and means position of the Government became more comfortable.

The Railways' capital programme in 1951-2 would amount to Rs. 66·5 crores. Out of this, Rs. 38 crores would be required under rolling stock and machinery, Rs. 26 crores under works, Rs. 1·5 crores for investments in the shares of Tata Engineering and Locomotive Co. Ltd and Rs. 0·5 crores in road services.

The budget provision in 1951-2 for new acquisitions of rolling stock including the orders placed abroad is Rs. 24 crores. The most important engineering project included in the budget is the Mukerian-Pathankot project for which a provision of Rs. 200 lakhs has been made in the coming year. Rs. 3 crores will go to passenger amenities and Rs. 4·55 crores for quarters and staff amenities. Provision has also been made in the budget year for starting work on the restoration of eight of the lines which were dismantled during the war. Two new lines,

Pihij-Nadiad (B.B. & C. I.) and Chunar-Robertsganj (E.I.R.) have also been included in the budget, with an allotment between them of Rs. 50 lakhs.

The Minister referred to the first locomotive which steamed out of the Chittaranjan Locomotive Works on 1 November 1950. He stated that the factory was making good progress, that the targets of production which had been prescribed had been maintained and that 36 locomotives were expected to be turned out in the coming financial year. He referred to the plan for establishing a coach-building unit in the country and said that the progress in implementation had been somewhat retarded due to various reasons, but it was expected to take final shape in the next few weeks and a provision of Rs. 50 lakhs had been included in the estimates for 1951-2.

The Minister stated that in the past adequate attention had not been given to improving the metre-gauge systems, and that there had been legitimate complaints from the areas served by them. He told Parliament that special steps had now been initiated to remove these complaints. One hundred and fifty improved type Y.P. locomotives, 8,000 metre-gauge wagons, and 250 metre-gauge third class bogie coaches had been ordered and it was expected that, when these were put into service, the performance of the metre-gauge system would be brought up to the level of the broad-gauge system.

The Minister for Railways stated that, with the constitutional changes and with a Minister responsible to Parliament coming to be in charge of the Railways, the functioning of the Railway Board had altered substantially. Under the present arrangement, the Chief Commissioner was not in charge of any specific portfolio and was responsible merely for presiding at the Board's meeting and for overall functional supervision and co-ordination of work. In the changed constitutional position, overall co-ordination was actually ensured at the Ministers' level and so the need for an officer in the Board, who was not burdened with departmental responsibilities, was not by any means compelling. He announced that, with the retirement from 1 April 1951 of Mr K. C. Bakhle, the present Chief Commissioner of Railways, the post of the Chief Commissioner would be retrenched, and the Board would be reconstituted with three functional members and the Financial Commissioner. The Secretary of the Transport Ministry would, as at present, continue *ex-officio* to be an additional member. One of the functional members would be appointed Chairman of the Board and in that capacity, function *ex-officio* as Secretary to the Ministry. He would be responsible for the work of the Board as such and for the inter-Board co-ordination required for this purpose. He would also be in charge of the small Secretariat attached to the Board in addition to being a functional member. The Financial Commissioner would retain his special position and function as Secretary to the Ministry in matters financial. The Board would function as a corporate body advising the Minister on all major questions of policy and issuing such executive orders as might be necessary for the administration of the Indian Railways.

INDEX